ACCOUNTING FOR PARTNERSHIP

CHAPTER – 1

ACCOUNTING FOR PARTNERSHIP FIRMS-FUNDAMENTALS

Due to the limitation of sole-tradership regarding limited capital, limited managerial abilities, the low scale of business, involves more risk due to unlimited liability, tie need of partnership arises. A partnership is a relation of mutual trust and faith. There are certain peculiarities in " the accounts of partnership firm than those are prepared in the sole tradership firm. The main peculiarities regarding the accounting of partnership firms are maintenance of the capital accounts of partners, distribution of profits to the partners, etc.

Meaning of Partnership:

The partnership is an agreement written/oral between two or more persons who have agreed to do some lawful business and to share profit or loss arising from the business.

According to the Indian Partnership Act, 1932, Section 4

"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."

In partnership, two or more persons join hands to set up a business and share its profit and losses.

Persons who have entered into a partnership with one another are called individually partners and collectively 'a firm', and the name under which their business is carried on is called the 'firm name'. A partnership firm is not a separate legal entity apart from the partners constituting it.

There must be a minimum of two persons to form a partnership firm, according to the Indian Partnership Act, 1932, but it does not specify the maximum number of partners. Section 464 of the Indian Companies Act, 2013, restricts the numbers of partners to be 50.

Features of Partnership

1. **Two or More Persons:** There must be a minimum of two persons to form a partnership firm, according to the Indian Partnership Act, 1932, but it does not specify the maximum number of partners, but Section 464 of Indian Companies Act,2013, restricts the number of partners to 50.
2. **Agreement:** Partnership comes into existence on account of an agreement among the partners, and not from status or operations of law. The agreement becomes the basis of the relationship between the partners. It may be written or oral. It may be for a fixed period or for a particular venture or at will.
3. **Business:** A partnership can be formed for the purpose of carrying on some lawful business with the intention of earning profits. Mere co-ownership of a property does not amount to a partnership.
4. **Mutual Agency:** The partnership business may be carried on by all the partners or any of them acting for all. This statement means that every partner is entitled to participate in the conduct of the affairs of its business and there exists a relationship of mutual agency between all the partners.
5. **Sharing of Profit:** The agreement between the partners must be to share the profits (or losses). Though the definition of partnership, according to Partnership Act, describes the partnership as the relationship between people who agree to share the profits of a business, the sharing of loss is implied.

6. **Liability of Partnership:** The liability of partnership is unlimited. Each partner is liable jointly with all the other partners and also individually to the third party for all the acts of the firm done while he is a partner.

Rights of a Partner

1. Every partner has the right to share profits and losses with other partners in the agreed ratio.
2. Every partner has the right to take part in the conduct of the business.
3. Every partner has the right to be consulted in the matters related to partnership business.
4. Every partner has the right to inspect and have a copy of the books of the accounts.
5. Every partner has a right to disallow the admission of a new partner.
6. Every partner is the joint owner of the partnership property.
7. If a partner has given loan to the firm, he has a right to receive interest at agreed rate. If the rate of interest is not agreed, it is paid @6% p.a.
8. If a partner incurs expenses or makes payment on behalf of the firm, he has a right to be indemnified by the firm.
9. Every partner has a right to retire from the firm after giving a proper notice.

Limited Liability Partnership (LLP)

The Limited Liability Partnership (LLPs) in India came into existence with the enactment of 'Limited Liability Partnership Act,2008' which lay down the law for the formation and regulation of Limited Liability Partnerships.

Definition: 'Limited Liability Partnership' means a partnership formed and registered under this Act.

Nature of Limited Liability Partnership (LLP)

(i) A LLP is a body corporate formed and incorporated under this act.

(ii) It is a legal entity separate from that of its partners.

(iii) A LLP shall have perpetual succession.

(iv) Any change in the partners of a LLP shall not affect the existence, rights or liabilities of the LLP.
Indian Partnership Act, 1932 does not apply to a LLP.

Distinction between an Ordinary partnership Firm and an LLP

Basics of Distinction		Partnerships	LLPs
1.	**Applicable Law**	Indian Partnership Act, 1932.	The Limited Liability Partnership Act, 2008.
2.	**Registration**	Optional	Compulsory with Registrar of Companies
3.	**Creation**	Created by an Agreement	Created by Law
4.	**Body Corporate**	Body Corporate cannot become partner.	Body Corporate can become its partner.
5.	**Separate Legal Entity**	It is not a separate legal entity.	It is a separate legal entity.
6.	**Perpetual succession**	Partnerships do not have perpetual succession.	It has perpetual succession and individual partners may come and go.
7.	**Number of Partners**	Minimum 2 and Maximum 50.	Minimum 2 but no maximum limit.
8.	**Ownership of Assets**	Firm cannot own any asset. The partners own the assets of the firm.	The LLP as an independent entity can own assets.
9.	**Liability**	Unlimited.	Limited to the extent of their contribution towards LLP.

Partnership Deed:

A partnership is formed by an agreement, it is essential that there must be some terms and conditions agreed upon by all the partners. These terms and conditions or Agreements may be written or oral. Though the Partnership Act does not expressly require that there should be an agreement in writing. But in order to avoid all misunderstandings and disputes, it is always the best course to have a written agreement duly signed and registered under the Act.

A document in writing which contains the terms of agreement for the partnership is called 'Partnership Deed'. This document contains the details about all the aspects affecting the relationship between the partners including the objectives of the business, the contribution of capital by each partner, ratio in which the profit and losses will be shared by the partners, and entitlement of partners to interest on capital, interest on the loan, etc. The clauses of the partnership deed can be altered with the consent of all the partners.

Contents of Partnership Deed:

1. Names and Addresses of the firm and its main business.
2. Names and Addresses of all partners.

3. Amount of capital contributed or to be contributed by each partner.
4. The accounting period of the firm.
5. Date of commencement of partnership firm.
6. Rules regarding operations of a bank account.
7. Profit and loss sharing ratio.
8. Duration of partnership, if any.
9. Rate of interest on capital, loan, drawings, etc.
10. Salaries, commissions, etc., if payable to any partner(s).
11. The rights, duties, and liabilities of each partner.
12. Mode of auditor's appointment, if any.
13. Rules to be followed in case of admission, retirement, death of a partner.
14. Rules to be followed in case of insolvency of one or more partners.
15. Settlement of accounts on the dissolution of the firm.
16. Rules for the settlement of disputes among the partners.
17. Safe custody of the books of accounts and other documents of the firm.
18. Any other matter relating to the conduct of business.

Provisions Relevant for (Affecting) Accounting of Partnership:
Normally, the partnership deed covers all matters relating to the mutual relationship of partners amongst themselves. But if the partnership silent on certain matters, or in the absence of any deed, the provisions of the Indian Partnership Act, 1932 shall apply.

The important provisions affecting partnership accounts are:

1. **Profit-Sharing Ratio:** In absence of deed or agreement, according to the act, the profit-sharing ratio is equal i.e. the profit and loss of the firm are to be shared equally by the partners, irrespective of their capital contribution in the firm.
2. **Interest on Capital:** No interest on capital shall be allowed to the partners. In case the deed provides for payment of interest on capital but does not specify the rate, the interest will be paid at the rate of 6% p.a., only from the profits of the firm. It is not payable if the firm incurs losses during the period.
3. **Interest on Drawings:** No interest is to be charged on drawings.
4. **Interest on Loan, Advances:** If any partner, apart from his capital, provides a loan to the firm, he is entitled to get interested at the rate of 6% per annum. Such interest shall be paid even if there a losses to the firm.
5. **Remuneration to Partners:** No partner is entitled to any salary or commission for participating in the business of the firm.

Apart from the above, the Indian Partnership Act specifies that subject to a contract between the partners:
1. If a partner derives any profit for himself/herself from any transaction of the firm or from the use of the property or business connection of the firm or the firm name, he/she shall account for the profit and pay it to the firm
2. If a partner carries on any business of the same nature as and competing with that of the firm, he/she shall account for and pay to the firm, all profit made by him/her in that business.

Difference between Profit and Loss Account and Profit and Loss Appropriation Account

Basis of Distinction	Profit and Loss Account	Profit and Loss Appropriation Account
Stage of Preparation	It is prepared after trading account and hence starts with the gross profits disclosed by Trading Account.	It is prepared after Profit and Loss Account and hence starts with net profit disclosed by Profit and Loss A/c
Objective	It is prepared to ascertain net profit or net loss.	It is prepared to distribute the divisible profit of the year among the partners
Opening/ Closing Balance	This account has neither opening balance nor closing balance.	This account may have opening as well as closing balances.
Charge or Appropriation	Expenses debited to this account are charge against profits.	Expenses debited to this account are appropriations against profits.
Partnership Agreement	This account is not prepared on the basis of partnership agreement, except for interest on loan on partners.	This account is prepared on the basis of partnership agreement.

Matching Principle	Matching Principle (i.e matching of revenue against expenses) is followed while preparing this account.	Matching Principle is not followed while this account.

Difference between Charge Against Profits and Appropriation out of Profit

Basis of Distinction	Charge against Profits	Appropriation Out of Profit
Nature	It indicates expense to be deducted from profits while calculating net profit or net loss.	It indicates distribution of net profit to various heads.
Recording	It is debited to Profit and Loss Account.	It is debited to Profit and Loss Appropriation Account.
Necessary or not	It is necessary to make charges against profits even if there is loss.	Appropriations are made only when there is profit.
Example	Interest on partner's loan and rent paid to a partner.	Interest on capital, partner's salary etc.

Maintenance of Capital Accounts of Partners:
There are two methods by which the capital accounts of partners are maintained. They are the following:
(a) Fixed Capital Method
(b) Fluctuating Capital Method

(a) Fixed Capital Method: Under the fixed capital method, the capitals of the partner shall remain fixed or unaltered unless some additional capital is introduced or some amount of capital is withdrawn with the consent of all the partners.

In this method, two accounts for each partner are to be maintained:
1. Capital Account
2. Current Account.

1. **Capital Account:** This account is credited with the amount of capital introduced by the partner. This account will continue to show the same balance from year to year unless some amount of capital is introduced or withdrawn. This account always appears on the liabilities side in the balance sheet.

2. **Current Account:** All entries relating to drawings, interest on capital, interest on drawings, salary or commission, the share of profit or loss, etc. are made in this account. This account is debited with drawings, interest on drawings, the share of loss, etc. and credited with the interest on capital, salary, commission, the share of profit, etc. The balance of this account will fluctuate from year to year. If it has a credit balance then it will appear on the liabilities side of the Balance Sheet and if it has a debit balance then it will appear on the assets side of the Balance Sheet.

The format of the Capital Account and Current account are as follows (Fixed Capital Accounts):

Dr. Capital Accounts Cr.

Particulars	A	B	Particulars	A	B
To Cash/ Bank A/c (Drawings against capital or permanent with-drawl of capital) To balance c/d (closing balance)			By balance b/d (Opening Balance) By Cash/Bank A/c (Additional Capital)		

Dr. Current Accounts Cr.

Particulars	A	B	Particulars	A	B
To balance b/d (In case of debit opening balance) To Drawings (Drawings against profits) To Interest on Drawings To P and L A/c (share in loss, in case of loss) To balance c/d			By balance b/d (in case of opening balance) By Interest on Capital By Partner's Salary By Partner's Commission By P and L Appropriation A/c (share of profit, in case of profit)		

(b) Fluctuating Capital Method: Under this method, only one account i.e. Capital Account is maintained for each partner. All the entries relating to the interest on capital, salary, commission to partners, the share of profit and loss, drawings, interest on drawings, etc. are directly recorded in the capital accounts of the partners. The balance of this account fluctuates from year to year. The format of Fluctuating Capital Account is as follows:

Partner's Capital Account (Fluctuating Capital Accounts)

Dr. **Capital Accounts** **Cr.**

Particulars	A	B	Particulars	A	B
To Cash/Bank A/c (Drawings against capital) To Drawings (Drawings against profits) To Interest on Drawings To P and L A/c (share in loss, in case of loss) To balance c/d(Closing Balance)			By balance b/d (in case of opening balance) By Cash/Bank A/c (additional capital) By Interest on Capital By Partner's Salary By Partner's Commission By P and L Appropriation A/c (share of profit, in case of profit)		

Difference between Fixed and Fluctuating Capital Accounts

Basis	Fixed Capital Account	Fluctuating Capital Account
Number of Accounts maintained	In this method, two different accounts are maintained for each partner i.e. 'Capital Account' and 'Current Account'.	In this method only one account is maintained for each partner i.e., 'Capital Account'.
Change in Capital	When the capitals are fixed, the balances in capital accounts remains unchanged during the life-time of the business, except when capital is introduced or withdrawn permanently.	When the capitals are fluctuating, the balances in capital accounts go on changing from time to time.
Recording of Transactions	When the capitals are fixed, transactions related to drawings, interest on drawings, salary, share of profit etc. are not made in Capital Accounts but are entered in separate Current Accounts.	In this case all transactions relating to partners are made directly in Capital Accounts itself.
Negative Balance	Fixed Capital Account can never show a negative balance.	Fluctuating Capital Account can show a negative balance.

Profit and Loss Appropriation Account:
In partnership, net profit after adjustment of partner's interest on capital, salary, and commission to partner's, interest on drawings, etc. is distributed among the partners in the agreed profit sharing ratio. For this purpose, a separate account is prepared called Profit and Loss Appropriation Account.
It is merely an extension of the Profit and Loss Account. All adjustments in respect of partner's commission and salary, interest on capital and on drawings, etc. are made through this account. It starts with the net profit/net loss as per the Profit and Loss Account is transferred to this account.

Journal Entries relating to Profit and Loss Appropriation Account:

1. **Transfer of Net Profit/Net Loss as per Profit and Loss Account to Profit and Loss Appropriation Account:**

(a) **If Profit:**
Profit and Loss A/c Dr.
To Profit and Loss App. A/c

(b) **If Loss:**
Profit and Loss App. A/c Dr.
To Profit and Loss A/c

2. **Interest on Capital:**

(a) **For crediting interest on capital to partner's Capital/Current Account:**
Interest on Capital A/c Dr.
To Partner's Capital A/c or Current A/c (Individually)

(b) **For transferring interest on Capital to Profit and Loss Appropriation A/c:**
Profit and Loss App. A/c Dr
To Interest on Capital A/c OR

Only one entry may be passed in place of the above two entries:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c (Individually)

3. **Interest on Drawings:**

(a) **For charging interest on drawings to partner's Capital/ Current A/c:**
Partners Capital/Current A/c (Individually) Dr.
To Interest on Drawings A/c

(b) **For transferring interest on drawings to Profit and Loss Appropriation Account:**
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c OR

Only one entry may be passed in place of the above two entries:
Partner's Capital/Current A/c (Individually) Dr.
To Profit and Loss Appropriation A/c

4. Salary to Partner(s):

(a) **For crediting partner's salary' to partner's Capital/Current A/c:**
Salary to Partner A/c Dr.
To Partner's Capital /Current A/c (Individually)

(b) **For transferring partner's salary to Profit and Loss Appropriation A/c:**
Profit and Loss Appropriation A/c Dr.
To Salary to Partner A/c OR

Only one entry may be passed in place of the above two entries:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c (Individually)

5. Commission to Partner(s):

(a) **For crediting partner's commission to partner's Capital/ Current A/c:**
Commission to Partner A/c Dr.
To Partner's Capital/Current A/c (Individually)

(b) **For transferring partner's commission to Profit and Loss Appropriation A/c:**
Profit and Loss Appropriation A/c Dr.
To Commission to Partner A/c OR

Only one entry may be passed in place of the above two entries:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c (Individually)

6. Share of Profit/Loss after adjustments:

(a) **If Profit**
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c (Individually)

OR

(b) **If Loss:**
Partner's Capital/Current A/c (Individually) Dr.
To Profit and Loss Appropriation A/c

Format of Profit and Loss Appropriation Account is given below:

Profit and Loss Appropriation A/c

Dr. **For the year ended 31st March, 20XX** **Cr.**

Particulars		₹	Particulars		₹
To Profit and Loss A/c (Net Loss)		---	By Profit and Loss A/c (Net Profit)		---
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/Current A/c	---				
B's Capital/Current A/c	---	---			
		---			---

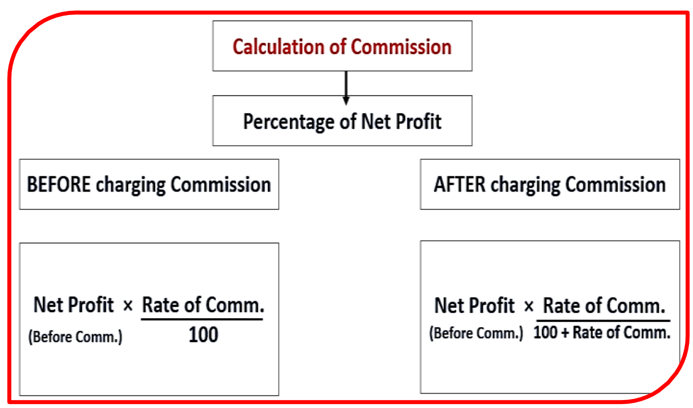
Manager's Commission to Net Profits :
Sometimes, a manager is to be allowed a certain percentage of net profits as his commission. It is calculated as below:

(I) On profits before charging such commission: For example, if the profit before charging commission is ₹22,000 and the manager is to be allowed a commission of 10% on the profit before charging commission, the commission will be:

$22,000 \times \frac{10}{100} = ₹2,200$

(II) On profits after charging such commission: For example, if the profit before charging commission is ₹22,000 and the manager is to be allowed a commission of 10% on the profit after charging commission, the commission will be:

$22,000 \times \frac{10}{110} = ₹2,000$



Interest on Partner's Loan to the firm

Rate of Interest : If a partner has given loan to the firm, he is entitled to receive interest on such loan at an agreed rate of interest. However, if there is no agreement as to the rate of interest, he is entitled to receive interest on loan @6% per annum.

Nature of Interest : Interest on partner's loan is a charge against the profits and hence, such interest is allowed whether profit are profits or not.

Accounting Treatment : It is treated as a charge against the profits and hence interest on partner's loan is debited to Profit and Loss A/c and not to Profit and Loss Appropriation A/c.

It must also be noted that interest on partner's loan is not credited to the partner's Capital or Current Accounts. It is credited to his loan Account

The following entries are passed for Interest on Partner's Loan:

(i) For providing Interest on Partner's Loan :
Interest on Partner's Loan A/c Dr.
To Partner's Loan A/c

(ii) For closing the Interest on Partner's Loan A/c :
Profit and Loss A/c Dr.
To Interest on Partner's Loan A/c

Interest on Loan taken by a partner from the firm

The Indian Partnership Act 1932 does not provide for charging interest on loan taken by a partner from the firm. Hence, interest on loan to the partner if the Partnership Deed has a clause in this respect or when the partners have agreed to the rate of interest on such loan.

Nature of Interest: Interest on loan taken by a partner is a gain for the firm and is recorded on the credit side of Profit and Loss A/c.

Accounting Treatment: Interest on Loan taken by a partner from the firm is credited to Profit and Loss Account and debited to his Capital/ Current Account.

The following entries are passed for it :

(i) For charging Interest on Loan to a Partner :
Partner's Capital/ Current A/c Dr.
To Interest on Partner's Loan A/c

(ii) For closing the Interest on Partner's Loan A/c
Interest on Partner's Loan A/c Dr.
To Profit and Loss A/c

Rent Paid to a Partner :

Like interest on partner's loan, rent paid to a partner is also treated as a charge against profit and not an appropriation out of profit and hence it should be debited to Profit and Loss Account and not to Profit and Loss Appropriation Account and credited to Rent Payable Account.

In case of Loss to Firm

If the firm incurs loss during the year, partners will not be allowed any interest on capital nor any salary. Also, there is no profit to be appropriated, as such, Profit and Loss Appropriation Account will not be prepared and losses will be distributed through Profit and Loss Account.

When Appropriations are more than Profits

In case where appropriations such as interest on capital, salary to partners etc. are more than available profits, the profits will be distributed in the ratio of appropriations.

Interest on Capital:

Interest on Capital is generally provided for in two situations:

1. When the partners contribute unequal amounts of capital but share profits equally.
2. When the capital contribution is the same but profit sharing is unequal.

Interest on Capital =Amount of capital × $\frac{Rate}{100}$ × Time

When there are both addition and withdrawal of capital by the partners during the financial year, the interest on capital can be calculated as:

1. On the opening balance of Capital A/c, interest is calculated for the whole year.
   If the closing balance of the Capital A/c is given then we have to find the opening balance of Capital A/c:

   Closing Capital + Drawings during the year + Interest on Drawing – Share of Profits – Salary to Partner – Commission to Partner – Additional Capital = Opening Capital

2. On the additional capital brought in by any partner during the year, interest is calculated from the date of introduction of additional capital to the last day of the financial year

3. On the amount of capital withdrawn (other than usual drawings) during the year interest for the period from the date of withdrawal to the last day of the financial year is calculated and deducted from the total of the interest calculated under points (1) and (2) above.

Or

Drawing has been made then the amount deducted from the capital and interest is calculated on the balance amount.

The interest on capital is allowed only when there is profit during the financial year. No interest will be allowed on capital if the firm has incurred a net loss during the year. If the profit of the firm is less than the amount due to the partners as interest on capital, the payment of interest will be restricted to the number of profits. In other words, profit will be distributed in the ratio of interest on capital of each partner.

Interest on Drawings:

Drawings is the amount withdrawn, in cash or in-kind, for personal use by the partner(s). Interest on drawings is calculated with reference to the date of withdrawal.

The calculation of interest on drawings under different situations is shown as under:

(a) When Fixed Amount is Withdrawn Every Month/Quarter:

If the equal amount is withdrawn at equal intervals of times, interest on the drawing can be calculated by Monthly/Quarterly Drawing Methods. While calculating the time period, attention must be paid to whether the fixed amount was withdrawn on the first day (beginning) of the month, at the last day (end) of the month, middle of the month, at the beginning of the Quarter or at the end of

Quarter. Depending upon the time period the interest on drawings can be calculated as follows:

When drawings are made:

1. **At the beginning of each month of the financial year:**
   Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{6.5}{12}$
   Here, time period is 6.5 months.
2. **At the middle of each month of the financial year**:
   Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{6}{12}$
   Here, time period is 6 months.
3. **At the and of each month of the financial year:**
   Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{5.5}{12}$
   Here, time period is 5.5 months.
4. **At the beginning of each quarter of the financial year:**
   Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{7.5}{12}$
   Here, time period is 7.5 months.
5. **At the end of each quarter of the financial year:**
   Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{4.5}{12}$
   Here, time period is 4.5 months.

(b) When Varying Amounts are Withdrawn at Different Intervals: When the partners withdraw different amounts of money at different time intervals, the interest is calculated using the production method. In this method, each amount of drawing is multiplied by the number of days/months (from the date of drawings to the last date of the financial year) to find out the product and then all the products are totaled. Here, the total product and interest for 1 month at the given rate are calculated.

Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{1}{12}$

(c) When Dates of Withdrawal are Not Specified: When the total amount withdrawn is given but the dates of withdrawals are not specified, then it is assumed that the amount was withdrawn evenly throughout the year. Here, the time period is taken 6 months.

Interest on Drawings = Total drawings $\times \frac{Rate}{100} \times \frac{6}{12}$

Guarantee of Profit to a Partner:

Sometimes a partner may be guaranteed a minimum amount of profit by one or some or by all the partners in the existing profit sharing ratio or some other agreed ratio. The minimum guaranteed amount shall be paid to a partner when his share of profit as per the profit-sharing ratio is less than the guaranteed amount.

The following steps may be followed in this case:

1. Calculate the share of profit of the partner who has been guaranteed a minimum amount of profit as per profit sharing ratio. If this amount is more than or equal to the amount guaranteed, no adjustment is required.
2. If the share of profit of that partner is less than the guaranteed amount, then we have to find out the difference between the guaranteed amount and the share of profit of that partner.
3. Then, we add this difference to the share of the profit of the partner and deduct the difference from the share of profit of other partners or partner who has guaranteed the amount in the agreed ratio.

Past Adjustments:

Sometimes, after making of final accounts and the distribution of profits among the partners, a few omissions or errors in the recording of transactions or the preparation of summary statements are found. These errors or omissions need adjustments for correction of their impact.

This error or omissions may relate to:

1. Interest on capital may have omitted or have been wrongly treated.
2. Interest in drawings may have been omitted.
3. Salary or commission payable has been omitted in the capital account of the partner.
4. The profit-sharing ratio has been changed from the past.
5. Interest in the partner's loan has been omitted.

In such cases, instead of altering the closed accounts and the signed balance sheet rectification or adjustment is made at the beginning of the next year.

These ways or omissions may be rectified in two ways :

(A) By passing a single adjustment entry with the net effect of the errors or omissions; or

(B) By passing separate adjustment entries for each error and omission.

(A) When a single Adjustment Entry is passed : In this case, a single adjustment entry is passed with the net amount of all the past adjustments.

(B) When Separate Adjustment Entries for each error and omission are passed : In this case, in place of a single adjustment entry, separate journal entries are passed for each error or omission. In such situation, analytical table to find out net effect of all adjustments is not prepared instead separate journal entries are passed for each error or omission by debiting or crediting Profit and Loss Adjustment A/c.

Solved Examples

Q1. *P* and *Q* are partners sharing profits in the ratio of 3 : 2, with Capitals of ₹ 5,00,000 and ₹3,00,000 respectively. Interest on Capital is agreed @6% p.a. *Q* is to be allowed an annual salary of ₹60,000. During the year 2019–20, the profits prior to the calculation of interest on capital but after charging *Q*'s salary amounted to ₹1,80,000. P provision of 5% of the profit is to be made in respect of commission to the Manager. Prepare Profit and Loss Appropriation account showing the distribution of profit and the partner's capital accounts for the year ending March 31, 2020.

SOLUTION:

PROFIT AND LOSS ACCOUNT

DR. ***for the year ended March 31, 2020*** ***Cr.***

Particulars	₹	*Particulars*	₹
To Manager's Commission (5% of ₹2,40,000)	12,000	By Profit for the year (before Q's salary) (₹1,80,000 + ₹60,000)	2,40,000
To Net Profit Transferred to Profit & Loss Appropriation A/c	2,28,000		
	2,40,000		2,40,000

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	*Particulars*	₹
To *B*'s Salary		60,000	By Profit & Loss A/c	2,28,000
To Interest on Capitals:				
P	*30,000*			
Q	*18,000*	48,000		
To Profits transferred to:				
P's Capital A/c	72,000			
Q's Capital A/c	48,000	1,20,000		
		2,28,000		2,28,000

Dr. **PARTNER'S CAPITAL ACCOUNTS** **Cr.**

Date	*Particulars*	*P*	*Q*	*Date*	*Particulars*	*P*	*Q*
2020		₹	₹	2019		₹	₹
				April 1	By Balance b/d	5,00,000	3,00,000
March 31	To Balance c/d	6,02,000	4,26,000				
				2020			
				March 31	By Salary	––	60,000
				March 31	By Interest on Capital	30,000	18,000
				March 31	By Profit & Loss Appr. A/c (Share of Profit)	72,000	48,000
		6,02,000	4,26,.000			6,02,000	4,26,000

Note:

(1) In the absence of information, manager's commission will be calculated on profit before any adjustment is made according to partnership deed, *i.e.*, before adjustments in respect of partner's salary, interest on capital etc.

(2) Manager's Commission is a charge against the profits and not an appropriation of profit. Hence it is debited to Profit & Loss Account and not profit and Loss Appropriation Account.

Q2. *M* and *N* are partners sharing profits and losses in the ratio of 2 : 1. *M* is a non-working partner and has contributed ₹12,00,000 as his capital. *N* is a working partner. The partnership deed provides for interest on capital @ 10% p.a. and salary of ₹7,500 per month to the working partner. The net profit for the year ended 31st March, 2021 before providing for interest on capital and salary amounted to ₹70,000. You are required to show the distribution of profit.

SOLUTION:

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. ***for the year ended 31st March, 2021*** **Cr.**

Particulars	₹	Particulars	₹
To Interest on M's Capital (4/7 of 70,000)	40,000	By Profit & Loss A/c (Net Profit)	70,000
To Salary to N (3/7 of 70,000)	30,000		
	70,000		70,000

Working Note :

	₹
Interest on *M*'s Capital = 10% on ₹12,00,000	1,20,000
Salary of *N* = ₹7,500 × 12	90,000
	2,10,000

Since available profit is only ₹70,000 which is less than appropriations of ₹2,10,000, profit will be distributed in the ratio of appropriations to be made:

Interest on Capital : Salary
Or 1,20,000 : 90,000
Or 4 : 3

Q3. Calculate the interest on drawings of Mr. Tarun @ 10% p.a. for the year ended 31st March, 2021 in each of the following alternative cases:

Case (*a*) If he withdrew ₹5,000 p.m. in the beginning of every month;
Case (*b*) If he withdrew ₹5,000 p.m. at the end of every month;
Case (*c*) If he withdrew ₹5,000 p.m. during the year;
Case (*d*) If he withdrew ₹60,000 during the year;
Case (*e*) If he withdrew as follows:

	₹
1st June, 2020	20,000
31st August, 2020	10,000
31st Oct., 2020	18,000
1st Feb., 2021	12,000

Case (*f*) If he -withdrew ₹15,000 in the beginning of each quarter;
Case (*g*) If he withdrew ₹15,000 at the end of each quarter;
Case (*h*) If he withdrew ₹15,000 during the middle of each quarter.

SOLUTION:

Case (*a*) Average Period $= \frac{12 \text{ months} + 1 \text{ month}}{2} = 6\frac{1}{2}$ months.

Interest on Drawings $= ₹60,000 \times \frac{10}{100} \times \frac{6.5}{12} = ₹3,250$

Case (*b*) Average Period $= \frac{11 \text{ months} + 0 \text{ month}}{2} = 5\frac{1}{2}$ months.

Interest on Drawings $= ₹60,000 \times \frac{10}{100} \times \frac{5.5}{12} = ₹2,750$

Case (*c*) Assuming that the drawings were made in the middle of every month:

Average Period $= \frac{11.5 \text{ months} + 0.5 \text{ month}}{2} = 6$ months.

Interest on Drawings $= ₹60,000 \times \frac{10}{100} \times \frac{6}{12} = ₹3,000$

Case (*d*) As the date of drawings is not given, interest will be calculated for an average period of 6 months.

Interest on Drawings $= ₹60,000 \times \frac{10}{100} \times \frac{6}{12} = ₹3,000$

Date	*Amount of Drawing*	*Period (months upto 31st March, 2021*	*Products*
	₹		₹
1st June, 2020	20,000	10	2,00,000
31st August, 2020	10,000	7	70,000
31st Oct., 2020	18,000	5	90,000
1st Feb., 2021	12,000	2	24,000
			3,84,000

Interest on Drawings = ₹3,84,000 $\times \frac{10}{100} \times \frac{1}{12}$ = ₹3,200

Case (*f*) Average Period $= \frac{12\ months + 3\ months}{2} = 7\frac{1}{2}$ months.

Total Drawings for the year = ₹15,000 × 4 times in a year = ₹60,000

Interest on Drawings = ₹60,000 $\times \frac{10}{100} \times \frac{7.5}{12}$ = ₹3,750

Case (*g*) Average Period $= \frac{9\ months + 0\ month}{2} = 4\frac{1}{2}$ months.

Interest on Drawings = ₹60,000 $\times \frac{10}{100} \times \frac{4.5}{12}$ = ₹2,250

Cash (*h*) Average Period $= \frac{10.5\ months + 1.5\ months}{2} = 6\ months.$

Interest on Drawings = 60,000 $\times \frac{10}{100} \times \frac{6}{12}$ = ₹3,000

Q4. *A* and *B* are partners sharing the profits and losses in the ratio of 3 : 2 with capitals of ₹ 2,00,000 and ₹1,00,000 respectively. Show the distribution of profits in each of the following alternative cases:

Case (i) If the partnership deed is silent as to the Interest on Capital and the profits for the year are ₹50,000.

Case (ii) If the partnership deed provides for Interest on Capital @ 8% p.a. and the losses for the year are ₹ 50,000.

Case (iii) If the partnership deed provides for Interest on Capital @ 8% p.a. and the profits for the year are ₹ 50,000.

Case (iv) If the partnership deed provides for Interest on Capital @ 8% p.a. and the profits for the year are ₹ 15,000.

Case (v) If the partnership deed provides for Interest on Capital @ 8% p.a. even if it involves the firm in loss and the profits for the year are ₹15,000.

SOLUTION: ***Case (i)***

Dr. **PROFIT AND LOSS APPROPRIATION A/C** **Cr.**

Particulars		**₹**	***Particulars***	**₹**
To Profit transferred to:			By Profit & Loss A/c	
A's Capital A/c 3/5	30,000		(Profit for the year)	50,000
B's Capital A/c 2/5	20,000	50,000		
		50,000		50,000

If the partnership deed is silent, no interest will be allowed on capitals.

Case (ii)

Dr. **PROFIT AND LOSS A/C** **Cr.**

Particulars	**₹**	***Particulars***		**₹**
To Balance b/d		By Loss transferred to:		
(Loss for the year)	50,000	A's Capital A/c 3/5 of	30,000	
		B's Capital A/c 2/5 of	20,000	50,000
	50,000			50,000

Note: (i) Interest on Capital will not be provided in case of loss.
(ii) Profit and Loss Appropriation Account will not be prepared in case of loss.

Case (iii)

Dr. **PROFIT AND LOSS APPROPRIATION A/C** **Cr.**

Particulars		₹	*Particulars*	₹
To Interest on Capital:			By Profit & Loss A/c	
A	16,000		(Profit for the year)	50,000
B	8,000	24,000		
To Profit transferred to:				
A's Capital A/c 3/5	15,600			
B's Capital A/c 2/5	10,400	26,000		
		50,000		50,000

Case (iv)

Dr. **PROFIT AND LOSS APPROPRIATION A/C** **Cr.**

Particulars	₹	*Particulars*	₹
To Interest on Capital: $A\ 15{,}000 \times \frac{2}{3}$ $B\ 15{,}000 \times \frac{1}{3}$	 10,000 5,000	By Profit & Loss A/c (Profit for the year)	 15,000
	15,000		15,000

Note:
The available profit is ₹15,000 whereas the interest due on capitals is ₹24,000 (*i.e.* ₹16,000 + ₹8,000). Since the profit is less than the interest, the available profit will be distributed in the ratio of interest, *i.e.*, 16,000 : 8,000 or 2 : 1.

Case (v)

Dr. **PROFIT AND LOSS A/C** **Cr.**

Particulars	₹	*Particulars*	₹
To Interest on Capital*: *A* *16,000* *B* *8,000*	 24,000	By Balance b/d (Profit for the year) By Loss transferred to: *A*'s Capital A/c 3/5 5,400 *B*'s Capital A/c 2/5 <u>3,600</u>	15,000 9,000
	24,000		24,000

* Interest on capital will be allowed even if firm incurs loss. It means interest on capital is a charge against profit. As such, it would be debited to profit and loss and not to profit and loss appropriation account.

Q5. The capital Accounts of Aman and Harish stood at ₹2,00,000 and ₹3,00,000 respectively after the necessary adjustments in respect of drawings and net profit for the year ended 31st march 2017. It was subsequently ascertained that interest on capital @ 12% per annum was not taken into account while arriving at the divisible profits for the year. During the year 2016-17, Aman had withdrawn ₹20,000 and Harish's drawings were ₹10,000. The net profit for the year amounted to ₹1,50,000. The partners shared profits and losses in the ratio of 3 : 2. You are required to pass the necessary journal entries to rectify the error in accounting.

SOLUTION JOURNAL

Date	*Particulars*	*L.F.*	*Dr. (₹)*	*Cr. (₹)*
2017				
April 1	Aman's Capital A/c Dr. Harish's Capital A/c Dr. To Profit & Loss Adjustment A/c (Incorrect profits cancelled)		90,000 60,000	 1,50,000
"	Interest on Capital A/c Dr. To Aman's Capital A/c To Harish's Capital A/c (Interest on capital provided)		45,600	 15,600 30,000
"	Profit & Loss Adjustment A/c Dr. To Interest on Capital A/c (Interest on Capital transferred to P & L Adjustment A/c)		45,600	 45,600
"	Profit & Loss Adjustment A/c Dr. To Aman's Capital A/c		1,04,400	 62,640
	To Harish's Capital A/c Correct profit credited to Partner's Capital A/cs)			41,760

Working Note:
(1) Calculation of Opening Capital:

Particulars	*Aman*	*Harish*
	₹	₹
Closing Capitals	2,00,000	3,00,000
Add: Drawings	20,000	10,000
	2,20,000	3,10,000
Less: Profits (₹1,50,000 in 3 : 2)	90,000	60,000
	1,30,000	2,50,000
Interest on Capital @ 12%	15,600	30,000

Q6. Aman, Babita and Suresh are partners in a firm. Their profit-sharing ratio is 2 : 2 : 1. However, Suresh is guaranteed a minimum amount of ₹10,000 as share of profit every year. Any deficiency arising on that account shall be met by Babita. The profits for the two years ending 31st March, 2020 and 2021 were ₹40,000 and ₹60,000 respectively. Prepare Profit and Loss Appropriation Account for the two years.

SOLUTION:

PROFIT AND LOSS APPROPRIATION ACOUNT

Dr. **For the year ending 31st March, 2020** **Cr.**

Particulars		**₹**	**Particulars**	**₹**
To Profit transferred to:			By Profit & Loss A/c	40,000
Aman's Capital A/c		16,000		
Babita's Capital A/c	16,000			
Less: Deficiency in				
Suresh's Share	2,000	14,000		
Suresh's Capital A/c	8,000			
Add: Defieincy met				
By Babita	2,000	10,000		
		40,000		40,000

Working Note:

Share of Profit:

Aman : $40{,}000 \times \frac{2}{5} = ₹16{,}000$

Babita : $40{,}000 \times \frac{2}{5} = ₹16{,}000$

Suresh : $40{,}000 \times \frac{1}{5} = ₹\ 8{,}000$

The minimum guaranteed amount to Suresh is ₹10,000 Whereas, his share of profit as per the profit sharing ratio works out to be ₹8,000 only. Hence, there is a shortfall of ₹2,000 which will be borne by Babita.

PROFIT AND LOSS APPROPRIATION ACOUNT

Dr. ***for the year ending 31st March, 2021*** **Cr.**

Particulars	₹	*Particulars*	₹
To Profit transferred to:		By Profit & Loss A/c	60,000
Aman's Capital A/c ($60{,}000\times\frac{2}{5}$)	24,400		
Babita's Capital A/c ($60{,}000\times\frac{2}{5}$)	24,000		
Suresh's Capital A/c ($60{,}000 \times \frac{1}{5}$)	12,000		
	60,000		60,000

Note:

Suresh's share is more than the guaranteed amount, hence there is no need for any adjustment.

QUESTIONS FOR PRACTICE

MCQ

1. Loan has been given by wife of a partner to the firm. Now partner wants interest @ 6% per annum as per Partnership Act, 1932 while partnership deed is silent. Solve this issue.
(a) Provide 6% per annum interest as partnership act says
(b) Provision of interest on loan @ 6% per annum of the partnership act does not apply
(c) Provide 10% interest to solve the issue
(d) None of the above

2. A partner withdrew ₹4,000 per month from 1st July, 2020, on beginning of every month. Accounts are closed at 31st March, 2021. Calculate interest on drawings while rate of interest is 10% per annum.
(a) ₹1,600
(b) ₹1,800
(c) ₹1,500
(d) ₹2,200

3. In a firm, 10% of net profit after deducting all adjustments, including reserve is transferred to general reserve. The net profit after all adjustments but before transfer to general reserve is ₹44,000. Calculate the amount which is to be transferred to reserve.
(a) ₹2,500
(b) ₹4,000
(c) ₹4,400
(d) ₹2,200

4. Where a partner is entitled to interest on capital contributed by him, such interest will be payable
(a) only out of profits
(b) only out of capital
(c) Both (a) and (b)
(d) None of the above

5. A charitable dispensary is run by 8 members. A new member wants to join them. The new member is of the opinion that partnership deed must be written while other members refused to do that. They said this is not a partnership. Give reason(s) in favour of other members.
(a) There is no business
(b) There is no sharing of profits
(c) There is no motive of profit making
(d) All of the above

6. Virat and Anushka are partners in a firm sharing profits and losses in 2 : 1 ratio. Their capital balance were ₹10,00,000 and ₹8,00,000 respectively.
The firm made profits during the year amounting to ₹ 3,45,000. Both partners are allowed salary of ₹2,500 per month.
Interest on capital is allowed @ 5% on capital balance. Calculate closing balance of capital for Virat and Anushka.
(a) V = ₹12,10,000, A = ₹9,35,000
(b) V = ₹12,35,000, A = ₹9,10,000
(c) V = ₹13,10,000, A = ₹9,85,000
(d) None of the above

7. The partnership agreement between Mahesh and Ramesh provides that
(i) profits will be shared equally.
(ii) Mahesh will be allowed a salary ₹ 400 per month.
(iii) Ramesh is allowed a commission @ 10% on net profits after all adjustments.
(iv) 10% per annum interest will be charged on drawings.
(v) their annual drawings were ₹16,000 and ₹14,000 respectively.
Net profit before above adjustments are ₹40,000. Calculate profits to be distributed between partners.
(a) ₹34,200 (b) ₹32,700
(c) ₹47,300 (d) ₹29,700

8. The capital balance of a partner at the end of the year (after adjusting for his drawings ₹3,500 and his share in the profit ₹ 2,300) is ₹12,000. Interest on capital is payable to him at 5% per annum. What will be the amount of interest on capital?
(a) ₹660
(b) ₹600
(c) ₹540
(d) None of these

9. Aman is a partner of Jivan firm with a fixed capital of ₹9,00,000. He withdrew ₹ 60,000 during financial year 2020-21. What will be the journal entry?

(a)	Drawings A/c	Dr	60,000
	To Aman's Current A/c		60,000
(b)	Drawings A/c	Dr	60,000
	To Aman's Capital A/c		60,000
(c)	Aman's Current A/c	Dr	60,000
	To Drawings A/c		60,000
(d)	Aman's Capital A/c	Dr	60,000
	To Drawings A/c Accountancy		60,000

10. Features of partnership include
(a) Two or more persons are carrying common business under an agreement
(b) They are sharing profits and losses in the fixed ratio
(c) Business is carried by all or any of them acting for all as an agent
(d) All of the above

11. If a partner withdraws equal amount at end of each quarter, then...... are to be considered for interest on total drawings.

(a) 5.5 months (b) 6 months
(c) 4.5 months (d) 7.5 months

12. Why a partnership firm needs partnership deed?
(a) It acts as a proof in any dispute
(b) It regulates rights of partners
(c) It represents duties and liabilities of partners
(d) All of the above

13. Under what circumstances, a partner can get exemption from sharing losses in a firm?
(a) If he is a senior citizen
(b) If he is senior
(c) If he is retiring partner
(d) All of the above

14. If partner's capitals are fixed, drawings will be recorded in
(a) partner's capital account
(b) partner's current account
(c) profit and loss appropriation account
(d) None of the above

15. Which of the following items is not dealt through profit and loss appropriation account?
(a) Interest on Partner's Loan
(b) Partner's Salary
(c) Interest on Partner's Capital
(d) Partner's Commission

16. In case of partnership, the act of any partner is
(a) binding on all partners
(b) binding on that partner only
(c) binding on all partners except that particular partner
(d) None of the above

17. Following are essential elements of a partnership firm except
(a) atleast two persons
(b) there is an agreement between all partners
(c) equal share of profits and losses
(d) partnership agreement is for some business

18. The firm of Sonu and Monu earned a profit of ₹ 3,25,000 during the year ending on 31st March, 2019. They have decided to donate 10% of this profit to an NGO working for senior citizens. Pass the journal entry.
(a) Profit and Loss Appropriation A/c Dr 2,92,500
To Sonu's Capital A/c 1,46,250
To Monu's Capital A/c 1,46,250
(b) Sonu's Capital A/c Dr 1,46,250
Monu's Capital A/c Dr 1,46,250
To Profit and Loss Appropriation A/c 2,92,500
(c) Profit and Loss Appropriation A/c Dr 32,500
To Monu's Capital A/c 16,250
To Sonu's Capital A/c 16,250
(d) Profit and Loss A/c Dr. 2,92,250
To Sonu's Capital A/c 1,46,250
To Monu's Capital A/c 1,46,250

19. Pinky and Chinky are partners in a firm. They share their profits in 2 : 3 ratio. The accountant of the firm, finalised the profit and loss and capital account and presented the accounts to them.
Pinky disagreed with accounts because Pinky's capital account showed negative balance. Pinky is in doubt, this cannot happen. Give your opinion.
(a) Pinky is wrong
(b) Pinky is correct
(c) Accountant is defaulter
(d) None of the above

20. Manager's commission of ABC Ltd. (Partnership) was ₹33,000. What amount of net profit in manager's commission was to be charged @10% before charging such commission?
(a) ₹3,30,000
(b) ₹3,00,000
(c) ₹3,000
(d) ₹3,300

SUBJECTIVE QUESTIONS

1. P and Q were partners in a firm sharing profits and losses equally. Their fixed capitals were ₹2,00,000 and ₹3,00,000 respectively. The partnership deed provided for interest on capital @12% per annum. For the year ended 31st March, 2016, the profits of the firm were distributed without providing interest on capital.
Pass necessary adjustment entry to rectify the error.

2. Kajal, Neerav and Alisha are partners in a firm sharing profit in the ratio of 3:2:1. They decided to admit Rajan, their landlord as a partner in the firm. Rajan brought sufficient amount of capital and his share of goodwill premium. The accountant of the firm passed the entry of rent paid for the building to Rajan in 'Profit and Loss Appropriation Account'. Is he correct in doing so? Give reason in support of your answer.

3. A and B are partners. The net divisible profit as per Profit and Loss Appropriation Account is ₹2,50,000. The total interest on partners' drawing is ₹4,000. A's salary is ₹4,000 per quarter and B's salary is ₹40,000 per annum. Calculate the net profit/loss earned during the year.

4. A and B were partners in a firm sharing profits in the ratio of 5 : 3. Their fixed capitals on 31st March, 2017 were : A ₹ 60,000 and B ₹80,000. They agreed to allow interest on capital @ 12% p.a. The profit of the firm for the year ended 31st March, 2018 before allowing interest on capitals was ₹12,600.

Pass necessary journal entries for the above transactions in the books of A and B. Also show your working notes clearly.

5. Arun and Arora were partners in a firm sharing profits in the ratio of 5:3. Their fixed capitals on 1-4-2016 were: Arun ₹60,000 and Arora ₹80,000. They agreed to allow interest on capital @ 12% p.a. and to charge on drawings @ 15% p.a. The profit of the firm for the year ended 31-3-2017 before all above adjustments was ₹12,600. The drawings made by Arun were ₹2,000 and by Arora ₹4,000 during the year. Prepare Profit and Loss Appropriation Account of Arun and Arora. Show your calculations clearly. The interest on capital will be allowed even if the firm incurs loss.

6. Mona, Nisha and Priyanka are partners in a firm. They contributed ₹50,000 each as capital three years ago. At that time Priyanka agreed to look after the business as Mona and Nisha were busy. The profits for the past three years were ₹15,000, ₹25,000 and ₹50,000 respectively. While going through the books of accounts, Mona noticed that the profit had been distributed in the ratio of 1:1:2. When she enquired from Priyanka about this, Priyanka answered that since she looked after the business she should get more profit. Mona disagreed and it was decided to distribute profit equally retrospectively for the last three years.

You are required to make necessary corrections in the books of accounts of Mona, Nisha and Priyanka by passing an adjustment entry.

7. A and B entered into partnership on 1st April, 2016 without any partnership deed. They introduced capitals of ₹5,00,000 and ₹3,00,000 respectively. On 31st October, 2016, A advanced ₹2,00,000 by way of loan to the firm without any agreement as to interest. The Profit and Loss Account for the year ended 31.3.2017 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 the distribution of the profit between the partners and prepare the Capital Accounts of both the partners and Loan Account of 'A'.

8. A, B and C were partners in a firm having capitals of ₹60,000; ₹60,000 and ₹80,000 respectively. Their Current Account balances were A: ₹10,000; B: ₹5,000 and C: ₹2,000 (Dr). According to the partnership deed, the partners were entitled to interest on capital @ 5% p.a. C being the working partner was also entitled to a salary of ₹6,000 p.a. The profits were to be divided as follows:

(a) The first ₹20,000 in proportion to their capitals.

(b) Next ₹30,000 in the ratio of 5:3:2.

(c) Remaining profits to be shared equally.

The firm made a profit of ₹1,56,000 before charging any of the above items.

Prepare the Profit and Loss Appropriation Account and pass necessary journal entry for apportionment of profit.

9. P and Q were partners in a firm sharing profits in the ratio of 5 : 3. On 1st April, 2014 they admitted R as a new partner for 1/8th share in the profits with a guaranteed profit of ₹ 75,000. The new profit sharing ratio between P and Q will remain the same but they agreed to bear any deficiency on account of guarantee to R in the ratio 3 : 2. The profit of the firm for the year ended 31st March, 2015 was ₹4,00,000.

Prepare Profit and Loss Appropriation Account of P, Q and R for the year ended 31st March, 2015.

10. A, B and C were partners. Their capitals were ₹30,000, ₹20,000 and ₹10,000 respectively. According to the partnership deed, they were entitled

HOMEWORK

MCQ

1. When drawings of equal amount are made during a year, at the beginning of every month, the average period is __ months.
(a) 5.5 (b) 6
(c) 6.5 (d)7

2. Salary to a partner is _____ with respect to profit.
(a) charge (b) appropriation
(c) Both (a)and (b) (d) None of these

3. Which of these is not a feature of partnership?
(a) At least two persons
(b) Conduct of business for profit
(c) Written agreement between all partners
(d) Partners are agents and principals to business

4. Articles of partnership is also known as
(a) Partnership prospectus
(b) Partnership deed
(c) Principles of partnership
(d) None of the above

5. Formation of partnership deed is not mandatory.
(a) True (b) False
(c) Can't say (d) Partially true

6. Rob and Roy are partners in 2: 8. Before profit distribution, Roy is entitled to 5% commission of net profit (after charging such commission). Before charging commission, firm's profit was ₹2,10,000. Roy's share of profit was
(a) ₹1,68,000 (b) ₹1,60,000
(c) ₹1,70,000 (d) ₹10,000

7. Aman, Bhanu and Chandan are partners who share profits and losses in 2 : 3 : 2. Aman guaranteed Chandan a profit of ₹ 5,000. The firm earned ₹14,000. Aman's share will be
(a) ₹4,000 (b) ₹3,600
(c) ₹3,000 (d) ₹5,000

8. Match the following

Column – I (In absence of partnership deed)	**Column – II (Provision)**
A. Interest on Capital	(i) Allowed
B. Interest on partner's loan	(ii) 1 : 1
C. Profits/Losses	(iii) 6% p.a
D. Partners allowed to withdraw	(iv) Not allowed

	A	B	C	D
(a)	(i)	(ii)	(iii)	(iv)
(b)	(i)	(iv)	(ii)	(iii)
(c)	(ii)	(iii)	(iv)	(i)
(d)	(iv)	(iii)	(ii)	(i)

9. X, Y, Z are partners with ₹ 1,000, ₹ 2,000, ₹ 3,000 capital respectively. Profits are to be divided equally. Interest on capital to be provided @20% p.a. Net profit is ₹ 900. What is X's share of profit?
(a) ₹400 (b) ₹300
(c) ₹150 (d) Can't say

10. X,Y and Z are partners in the ratio of 1:2:3. Salary to X ₹10,000 per month and to Y ₹15,000 per quarter was omitted and profits were distributed. What will be the rectifying entry.

(a)	Z's Capital A/c	Dr.	90,000
	To X's Capital A/c		90,000
(b)	X's Capital A/c	Dr.	90,000
	To Z's Capital A/c		90,000
(c)	Z's Capital A/c	Dr.	60,000
	To X's Capital A/c		60,000
(d)	X's Capital A/c	Dr.	60,000
	To Z's Capital A/c		60,000

Directions for questions 11 to 15: There are two statements marked as Assertion (a) and Reason (R). Read the statements and choose the appropriate option from the options given below.
(a) Both Assertion (a) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (a)
(b) Both Assertion (a) and Reason (R) are true, but Reason (R) is not the correct explanation of Assertion (a)
(c) Assertion (a) is false, but Reason (R) is true
(d) Assertion (a) is true, but Reason (R) is false

11. **Assertion** (A) Profit and loss adjustment account is required for rectification of errors or omissions.
Reason (R) This account is prepared to rectify those errors or omissions which are left while preparing final accounts and found after distribution of profits among partners.

12. **Assertion** (A) Interest on capital to a partner is payable only out of profits.
Reason (R) Interest on capital is an appropriation of profits which is required to be provided irrespective of profits or loss.

13. **Assertion** (A) It is considered desirable to have a partnership agreement in writing.
Reason (R) It helps in settling any disputes with regard to the terms of partnership and acts as an evidence in the court of law.

14. **Assertion** (A) The capital account of a partner does not show a debit balance inspite of regular and consistent losses year after year.
Reason (R) All transactions relating to loss or profit, drawings, salaries etc. are shown in the current account and not in capital account in case of fixed capitals.

15. **Assertion** (A) Salary paid to a partner is debited to profit and loss account.
Reason (R) Salary paid to a partner is an appropriation of profit.

Direction: Read the following case study and answer questions 16 to 20 on the basis of the same.
Aman and Dhruv are partners. Their capitals as on 1st April, 2020 are ₹1,00,000 and ₹2,00,000. Profits for year 2020-21 were ₹90,000. As per the agreement, interest on capitals were ₹10,000 and ₹ 20,000 respectively and interest on drawings was ₹6,000 and ₹10,000 respectively. Aman's salary was ₹ 2,000 per month and Dhruv's salary was ₹ 5,000 per year. Accountant, however, committed the mistake and credited the profit in the capital ratio, without taking interest on capitals/drawings and salary.

16. With what amount was Dhruv's account credited with initially?
(a) ₹30,000 (b) ₹45,000
(c) ₹60,000 (d) Can't say

17. What was the total salary required to be credited?
(a) ₹7,000 (b) ₹84,000
(c) ₹29,000 (d) Can't say

18. What was the interest rate of capitals?
(a) 5% (b)10%
(c)15% (d) Can't say

19. What was the amount of past adjustment entry?
(a) ₹20,500 (b) ₹21,500
(c) ₹23,500 (d) Can't say

20. What should have been Dhruv's original share of profit?
(a) ₹15,666 (b) ₹23,500
(c) ₹21,500 (d) ₹31,333

Directions: Read the following case study and answer questions 21 to 25 on the basis of the same.
Harsha and Kushal are partners in a firm. On 1st April, 2020, their capitals were ₹4,00,000 and ₹ 6,00,000. The profit for 2020-21 was ₹ 5,24,000. Partnership deed provided that interest on drawings/capital to be calculated @ 10%, Kushal had drawings of ₹ 1,00,000. He had withdrew this amount 31st December, 2020. In addition to this, rent (in case of any partner providing his premises for business) for premises decided to be ₹3,000 per month. Due to lockdown during pandemic, the partners decided to shut down factory and shifted to Harsha's farmhouse on 1st August, 2020.

21. What is amount transferred to profit and loss appropriation account?
(a) ₹5,24,000
(b) ₹5,00,000
(c) ₹4,88,000
(d) Can't say

22. What is interest on drawings of Kushal?
(a) ₹10,000 (b) ₹2,500
(c) ₹7,500 (d) Can't say

23. What is total interest on capitals of both partners?
(a) ₹1,00,000 (b) ₹50,000
(c) ₹2,00,000 (d) Can't say

24. What is net distributable profit?
(a) ₹5,00,000 (b) ₹4,00,000
(c) ₹5,02,500 (d) ₹4,02,500

25. What is the assumed profit sharing ratio?
(a) 3:1 (b) 3:2
(c) 1 : 1 (d) Can't say

Directions: Read the following case study and answer questions 26 to 30 on the basis of the same.
Lakhan and Karan are partners of a firm. Their capitals at the end of the year 2020-2021 was ₹3,00,000 and ₹1,50,000. During the year, Lakhan drawings were ₹40,000 and Karan drawings were ₹10,000. Profit from profit and loss account was ₹32,000. Out of this, ₹24,000 was credited in Lakhan's account and the balance was credited in Karan's capital account.

Karan also brought an additional capital of ₹32,000 on 1st October, 2020. The partnership deed provided for Interest on drawings @ 10% p.a. Interest on any capital introduced during the year @ 10%.

26. What was the profit sharing ratio of Lakhan and Karan?
(a) 2 : 1 (b) 1:1
(c) 3 : 1 (d) Can't say

27. What is Karan's interest on drawing ?
(a) ₹250
(b) ₹500
(c) ₹750
(d) ₹1,000

28. What is Lakhan's interest on capital?
(a) ₹3,200
(b) ₹1,600
(c) ₹ 800
(d) Can't say

29. What was initial capital of Lakhan?
(a) ₹3,16,000
(b) ₹1,20,000
(c) ₹3,40,000
(d) None of these

30. What was initial capital of Karan?
(a) ₹3,16,000
(b) ₹1,20,000
(c) ₹1,52,000
(d) ₹1,28,000

SUBJECTIVE QUESTIONS

1. Rakesh and Roshan are partners sharing profits in the ratio of 3:2 with capitals of ₹40,000 and ₹30,000 respectively. They withdraw from the firm the following amounts for personal use.

Partner	Date	Amount (₹)
Rakesh	31st May, 2017	600
	30th June, 2017	500
	31st August, 2017	1,000
	1st November, 2017	400
	31st December, 2017	1,500
	31st January, 2018	300
	1st March, 2018	700
Roshan	At the beginning of each month	400

Interest is to be charged @ 6% per annum. Calculate interest on drawing, assuming that books of accounts are closed on 31st March every year.

2. Kavita, Meenakshi and Gauri are partners doing a paper business in Ludhiana. After the accounts of partnership have been drawn up and closed, it was discovered that for the years ending 31st March, 2013 and 2014, Interest on capital has been allowed to partners@ 6% p.a. although there is no provision for interest on capital has been allowed by partnership deed. Their fixed capitals were ₹2,00,000; ₹1,60,000 and ₹1,20,000 respectively. During the last two years, they had shared the profits as under:

Year	Ratio
31st March, 2013	3:2:1
31st March, 2014	5:3:2

You are required to give necessary adjusting entry on 1st April, 2014.

3. Ahmad, Bheem and Daniel are partners in a firm. On 1st April, 2011 the balance in their capital accounts stood at ₹ 8,00,000, ₹6,00,000 and ₹ 4,00,000 respectively. They shared profits in the proportion of 5:3:2 respectively. Partners are entitled to interest on capital @5% per annum and salary to Bheem @ ₹3,000 per month and a commission of ₹12,000 to Daniel as per the provisions of the partnership deed.

Ahmad's share of profit, excluding interest on capital, is guaranteed at not less than ₹25,000 p.a. Bheem's share of profit, including interest on capital but excluding salary, is guaranteed at not less than ₹55,000 p.a. Any deficiency arising on that account shall be met by Daniel. The profit of the firm for the year ended 31st March, 2012 amounted to ₹2,16,000. Prepare 'Profit and Loss Appropriation Account' for the year ended 31st March, 2012.

4. A and B are partners sharing profits in the ratio of 3 : 2 with capitals of ₹50,000 and ₹30,000 respectively. Interest on capital is agreed @ 6% p.a. B is to be allowed an annual salary of ₹2,500. During the year ended 31st March, 2019 the profits of the year prior to calculation of interest on capital but after charging B's salary amounted to ₹12,500. A provision of 5% of the profits is to be made in respect of manager's commission.
Prepare an account showing the allocation of profits and partners' capital accounts.

5. Shreya and Vivek were partners in a firm sharing profits in the ratio 3 : 2. The balances in their capital and current accounts as on 1st April, 2017 were as under :

Particulars	Shreya (₹)	Vivek (₹)
Capital accounts	3,00,000	2,00,000
Current accounts	1,00,000 (Cr.)	28,000 (Dr.)

The partnership deed provided that Shreya was to be paid a salary of ₹5,000 p.m. whereas Vivek was to get a commission of ₹30,000 for the year.

Interest on capital was to be allowed @ 8% p.a. whereas interest on drawings was to be charged @ 6% p.a. The drawings of Shreya were ₹3,000 at the beginning of each quarter while Vivek withdrew ₹30,000 on 1st September, 2017. The net profit of the firm for the year before making the above adjustments was ₹1,20,000.

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

6. On 31st March, 2014 the balances in the Capital Accounts of Eleen, Monu and Ahmad after making adjustments for profits and drawings were ₹1,60,000, ₹1,20,000 and ₹80,000 respectively. Subsequently, it was discovered that the interest on capital and drawings had been omitted.
(i) The profit for the year ended 31st March, 2014 was ₹40,000.
(ii) During the year, Eleen and Monu each withdrew a total sum of ₹24,000 in equal instalments in the beginning of each month and Ahmad withdrew a total sum of ₹48,000 in equal instalments at the end of each month.
(iii) the interest on drawings was to be charged @5% p.a. and interest on capital was to be allowed @ 10% p.a.
(iv) The profit-sharing ratio among the partners was 2:1:1.

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

7. R, S and T were partners in a firm sharing profits in the ratio of 5:3:2 with capitals of ₹50,000, ₹24,000 and ₹26,000 respectively. Partners were entitled to 6% per annum interest on their capitals. R and S guaranteed T that his share of profits in any year would not be less than ₹10,000 excluding interest. During the year the firm had earned a profit of ₹48,000 before charging the interest on capital. R and S had also withdrawn ₹5,000 and ₹7,400 respectively. Prepare the Profit and Loss Appropriation Account.

8. Complete the following accounts of a partnership firm:

Profit and Loss Appropriation Account
Dr. for the year ended 31st March, 2019 Cr.

Particulars		(₹)	Particulars		(₹)
To General Reserve		15,000	By Net Profit		1,50,000
To Salary:			By Interest on Drawings:		
Gambhir	24,000		Gambhir	2,700	
Nihaal	18,000	42,000	Nihaal	2,475	5,175
To Interest on Capital:					
Gambhir	....				
Nihaal	....	....			
To Profit transferred to Current A/cs:					
Gambhir	17,505				
Nihaal	11,670	29,175			
		1,55,175			1,55,175

Dr. Partner's Capital Accounts Cr.

Particulars	Gambhir (₹)	Nihaal (₹)	Particulars	Gambhir (₹)	Nihaal (₹)
To Cash A/c	—	10,000	By Balance b/d	3,00,000	2,50,000
To Balance c/d	....	....	By Cash A/c	60,000	—
	3,60,000	2,50,000		3,60,000	2,50,000

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

Particulars	Gambhir (₹)	Nihaal (₹)	Particulars	Gambhir (₹)	Nihaal (₹)
To Drawings	40,000	40,000	By Salary	24,000	18,000
To Interest on Drawings	....	....	By Interest on Capital	39,600	29,400
To Balance c/d	....	....	By P & L App. A/c	....	....
	81,105	59,070		81,105	59,070

9. Following are the Profit and Loss Appropriation Account and Partners' Capital Accounts of Amar, Akbar and Anthony sharing profits and losses in ratio of 2:1:1. You are required to complete the missing entries and figures:

Profit and Loss Appropriation Account

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

Particulars	₹	Particulars	₹
To Interest on Capitals Amar 1,000 Akbar 800 Anthony 200	2,000	By	....
To	....		
To Akbar's Commission A/c (13,200 × 10/110)	1,200		
To Partner's Capital A/cs (Share in profit): Amar .... Akbar .... Anthony	....		
	17,200		17,200

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

Particulars	Amar	Akbar	Anthony	Particulars	Amar	Akbar	Anthony
To Drawings A/c	6,000	5,000	4,000	By Balance b/d	20,000	16,000	4,000
To Balance c/d	....	....	....	By Interest on Capital A/c	....	....	....
				By Salary A/c	....	....	2,000
				By Commission	....	....	....
				By P and L Appropriation A/c	6,000	3,000	3,000
	27,000	21,000	9,200		27,000	21,000	9,200

10. Anna and Bobby were partners sharing profits and losses in the ratio of 5 : 3. On 1st April, 2014 their Capital Accounts showed balances of ₹3,00,000 and ₹2,00,000 respectively. Calculate the amount of profit to be distributed between the partners if the Partnership Deed provided for Interest on Capital @ 10% p.a. and the firm earned a profit of ₹45,000 for the year ended 31st March, 2015.

SOLUTION FOR PRACTICE QUESTIONS

SOLUTION FOR MCQ QUESTIONS

1. **(b)**

2. **(c)** Interest on Drawings = 36,000 × $\frac{10}{100}$ × $\frac{5}{12}$ = ₹1,500

3. **(b)** Amount transferred to general reserve = 44,000 × $\frac{10}{110}$ = ₹4,000

4. **(a)**

5. **(d)**

6. **(a)** Divisible Profits = 3,45,000 – 60,000 – 90,000 = 1,95,000
   Virat's share of profit $\frac{2}{3}$ × 1,95,000 = ₹1,30,000
   Anushka's share of profit = $\frac{1}{3}$ × 1,95,000 = ₹65,000
   Closing capital of Virat = 10,00,000 + 30,000 + 50,000 + 1,30,000 = ₹12,10,000
   Closing capital of Anushka = 8,00,000 + 30,000 + 40,000 + 65,000 = ₹9,35,000

7. **(b)** Net profit as per Profit and Loss Account = ₹40,000
   Add: Interest on Drawings
   Ramesh (14,000 × $\frac{10}{100}$ × $\frac{6}{12}$) = ₹700
   Mahesh (16,000 × $\frac{10}{100}$ × $\frac{6}{12}$) = ₹800
   Less: Salary to Mahesh (12 ×400) = (4,800)
   Less: Commission to Ramesh (40,000 × $\frac{10}{100}$ = (4,000)
   Divisible Profits = ₹32,700

8. **(a)** Capital at beginning = 12,000 + 3,500 – 2,300 = ₹13,200
   Interest on Capital = 13,200 × $\frac{5}{100}$ = ₹660

9. **(c)**

10. **(d)**

11. **(c)** Time Period
    = $\frac{Time\ left\ after\ first\ drawings + Time\ left\ after\ last\ drawings}{2}$
    = $\frac{9+0}{2}$ = 4.5 months

12. **(d)**

13. **(b)**

14. **(b)**

15. **(a)**

16. **(a)**

17. **(c)**

18. **(a)**

19. **(a)**

20. **(a)** Let Profit be Y
    = Y × $\frac{10}{100}$ = 33,000 (Since before given)
    Y = ₹3,30,000

SUBJECTIVE QUESTIONS

1. **Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2016 April1	P's Current A/c Dr. To Q's Current A/c (Being the adjustment of interest on capital omitted in previous year)		6,000	6,000

2. No, accountant of the firm is not correct in doing so. Because rent paid is a charge against the profit and not an appropriation of profit so it should be debited to Profit and Loss Account.

3 Net Profit during the year = Divisible profits + Salary to partners –– Interest on Drawings
= 2,50,000 + 16,000 + 40,000 – 4,000 = ₹3,02,000

4 **Journal**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018				
March 31	Interest on Capital A/c Dr.		12,600	
	To A's Current A/c			5,400
	To B's Current A/c			7,200
	(Being interest on capital credited to Partners' Current A/cs)			
	P& L Appropriation A/c Dr.		12,600	
	To Interest on Capital A/c			12,600
	(Being interest on capital transferred to P& L Appropriation A/c)			

Working Notes:
Interest on Capitals:
A= 12% of ₹ 60,000 = ₹7,200, B = 12% of ₹80,000 = ₹9,600, Total interest = ₹16,800
Since profits are insufficient, Interest on capital will be credited in the ratio of 7,200:9,600
i.e. 3:4 so, A = 3/7 of ₹12,600 = ₹5,400, B = 4/7 of ₹12,600 = ₹7,200

5 **Profit and Loss Appropriation Account**
Dr. ***for the year ended 31st March, 2017*** **Cr.**

Particulars	**(₹)**	**Particulars**	**(₹)**
To Interest on Capital A/c:		By Profit and Loss A/c (Net profit)	12,600
Arun 7,200		Arun 150	
Arora 9,600	16,800	Arora 300	450
		By loss transferred to Partners Current A/cs:	
		Arun 2,343	
		Arora 1,407	3,750
	16,800		16,800

Working Notes:
1. Interest on Capital:
Arun –– ₹60,000 $\times \frac{12}{100}$ = ₹7,200, Arora — ₹80,000 $\times \frac{12}{100}$ = ₹9,600
2. Interest on Drawings:
Arun — ₹2,000 $\times \frac{15 \times 6}{100 \times 12}$ = ₹150, Arora — ₹4,000 $\times \frac{15 \times 6}{100 \times 12}$ = ₹300.

6 **Journal Entry**

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Priyanka's Capital A/c Dr.		15,000	
	To Mona's Capital A/c			7,500
	To Nisha's Capital A/c			7,500
	(Being adjustment entry passed)			

Working Notes:
(i) **Statement Showing Adjustment**

Particulars	Mona (₹)	Nisha (₹)	Priyanka (₹)	Total (₹)
Profit wrongly credited in 1:1:2 now debited	22,500	22,500	45,000	90,000
Profit should be credited equally	30,000	30,000	30,000	90,000
Net Effect	(Cr.) 7,500	(Cr.) 7,500	(Dr.) 15,000	–

(ii) Total Profits = Profit of 1st year + Profit of 2nd year + Profit of 3rd year = ₹15,000 + ₹25,000 + ₹50,000 = ₹90,000

7.

Profit and Loss Appropriation Account
for the year ended 31st March, 2017

Dr. Cr.

Particulars		**(₹)**	**Particulars**	**(₹)**
To A's Capital A/c	2,12,500		By Net Profit after interest on loan (₹4,30,000 – ₹5,000)	4,25,000
To B's Capital A/c	2,12,500	4,25,000		
		4,25,000		4,25,000

Dr. **Partners' Capital Accounts** Cr.

Date	**Particulars**	**A (₹)**	**B (₹)**	**Date**	**Particulars**	**A (₹)**	**B (₹)**
31-3-17	To Balance c/d	7,12,500	5,12,500	1-4-16	By Bank A/c	5,00,000	3,00,000
				31-03-17	By Profit & Loss Appropriation A/c	2,12,500	2,12,500
		7,12,500	5,12,500			7,12,500	5,12,500

Journal Entry

Date	**Particulars**	**L.F.**	**Dr. (₹)**	**Cr. (₹)**
31-3-17	Profit & Loss Appropriation A/c Dr.		4,25,000	
	To A's Capital A/c			2,12,500
	To B's Capital A/c			2,12,500
	(Being profit distributed between the partners)			

Dr. **A's Loan Account** Cr.

Date	**Particulars**	**(₹)**	**Date**	**Particulars**	**(₹)**
31-3-17	To Balance c/d	2,05,000	31-10-16	By Bank A/c	2,00,000
			31-03-17	By Interest on loan A/c	5,000
		2,05,000			2,05,000

8.

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

Particulars		**(₹)**	**Particulars**	**(₹)**
To Interest on Capital:			By Profit and Loss A/c (Net Profit)	1,56,000
A	3,000			
B	3,000			
C	4,000	10,000		
To Salary to C		6,000		
To Profit transferred to Current A/cs:				
A (6,000 + 15,000 + 30,000)	51,000			
B (6,000 + 9,000 + 30,000)	45,000			
C (8,000 + 6,000 + 30,000)	44,000	1,40,000		
		1,56,000		1,56,000

Journal Entry

Date	**Particulars**	**L.F.**	**Dr. (₹)**	**Cr. (₹)**
	Profit and Loss Appropriation A/c Dr.		1,40,000	
	To A's Current A/c			51,000
	To B's Current A/c			45,000
	To C's Current A/c			44,000
	(Being profit distributed among the partners)			

9 **Profit and Loss Appropriation Account of P, Q and R**

Dr. ***for the year ended 31st March, 2015*** **Cr.**

Particulars		**(₹)**	**Particulars**	**(₹)**
To Partners' Capital A/c (transfer of profit)			By Profit and Loss A/c (net profit)	4,00,000
P	2,18,750			
Less: Deficiency	15,000	2,03,750		
Q	1,31,250			
Less: Deficiency	10,000	1,21,250		
R	50,000			
Add: from P	15,000			
from Q	10,000	75,000		
		4,00,000		4,00,000

Working Note:

Calculation of New Profit-sharing ratio:

R's share $\frac{1}{8}$

Let total share = 1, Remaining share $= 1 - \frac{1}{8} = \frac{7}{8}$

P's share $= \frac{7}{8} \times \frac{5}{8} = \frac{35}{64}$; Q's share $= \frac{7}{8} \times \frac{3}{8} = \frac{21}{64}$

10. **Statement Showing Adjustment**

Particulars	**A**	**B**			**C**		**Firm**	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Profit wrongly credited in capital ratio (I)	15,000		10,000		5,000			30,000
Appropriations to be made (II)								
(i) Interest on capital		1,500		1,000		500	3,000	
(ii) Salary to B				6,000			6,000	
(iii) Commission to C						1,350	1,350	
(iv) Divisible profit in 2:2:1		7,860		7,860		3,930	19,650	
Net effect (I — ll)	5,640 (Dr.)		4,860 (Cr.)		780 (Cr.)		Nil	

Adjustment Entry:

A's Capital A/c	Dr	5,640
To B's Capital A/c		4,860
To C's Capital A/c		780
(Being adjustment entry passed)		

SOLUTION FOR HOMEWORK QUESTIONS

SOLUTION FOR MCQ QUESTIONS

1. (c)
2. (b)
3. (c)
4. (b)
5. (a)
6. (b)

Net Profit = ₹2,10,000; Commission $\left(2,10,000 \times \frac{5}{100}\right) =$ ₹10,000
Distribution Profit = 2,10,000 – 10,000 = ₹2,00,000
Roy's Share = 8/10 × 2,00,000 = ₹1,60,000

7. (c)

Particulars	**Aman(₹)**	**Bhanu(₹)**	**Chandan(₹)**
Initial share in 2 : 3 : 2	4,000	6,000	4,000
Guaranteed share	(1,000)	-	1,000
	3,000	6,000	5,000

8. (d)
9. (c)

Interest on capital
X = 1,000 × $\frac{20}{100}$ = ₹200; Y = 2,000 × $\frac{20}{100}$ = ₹200; Z = 1,000 × $\frac{20}{100}$ = ₹600;
So, total interest on capital = 200 + 400 + 600 = ₹1,200 which is less than net profit (i.e., ₹900)
Therefore, ₹900 will be divided in capital ratio between X, Y , Z i.e. 1,000 : 2,000 : 3,000 = 1 : 2 : 3
X's share 900 × $\frac{1}{6}$ = ₹150

10. (a)

Particulars	X	Y	Z	Total
Salary (Cr.)	1,20,000	60,000	-	1,80,000
1,80,000 in 1 : 2 : 3 (Dr.)	30,000	60,000	90,000	1,80,000
Net Effect	90,000(Cr.)	-	90,000 (Dr.)	-

11. (a)
12. (d)
13. (a)
14. (a)
15. (c)

Solutions for 16 to 20

Particulars	**Aman(₹)**	**Dhruv(₹)**
I. Amount already recorded (Dr.) 90,000 in (1 : 2) II. Amount which should have been recorded Interest on Capital Interest on Drawings Salary Share in Profit (in 1 : 1) (90,000 – 30,000 + 16,000 – 29,000)	30,000 10,000 (6,000) 24,000 23,500	60,000 20,000 (10,000) 5,000 23,500
Adjustment Entry	21,500 (Cr.)	21,500 (Dr.)

16. (c)

17. (c)

18. (b)

Interest on capital = Interest rate × Opening capital
Taking Aman's interest on capital in consideration,
10,000 = Interest rate × 1,00,000
Therefore Interest rate =10%

19. (b)
20. (b)

Solutions for 21 to 24

Particulars	**Amount(₹)**
Net Profits	5,24,000
(-) Rent for 8 months (8 × 3,000)	(24,000)
Profit in Profit and Loss Appropriation	5,00,0000
(+) Interest on Drawings $(1,00,000 \times \frac{10}{100} \times \frac{3}{12}$	2,500
(-) Interest on Capital $(10,00,000 \times \frac{10}{100})$	(1,00,000)
Net Distributable Profits	4,02,500

21. (b)

22. (b)

23. (a)

24. (d)

25. (c)

26. (c) Profit divided is ₹24,000 and ₹8,000 (32,000-8,000) i.e 3 : 1.

27. (b) Kush's interest on drawings= $10,000 \times \frac{6}{12} \times \frac{10}{100}$ = ₹500 (No date is given so 6 months)

28. (a) Luv's interest on capital = $32,000 \times \frac{10}{100} = 3,200$

29. (a) Statement showing Calculation of Capital at Beginning

Particulars	**Lakhan(₹)**	**Karan(₹)**
Capital at end	3,00,000	1,50,000
(+) Drawings	40,000	10,000
(-) Profit share	(24,000)	(8,000)
(-) Additional Capital	–	(32,000)
Capital in beginning	3,16,000	1,20,000

30. (b)

SUBJECTIVE QUESTIONS

1. Calculation of Interest on Rakesh's Drawings

Date of Drawings	Amt. withdrawn (₹)	Period (No. of Months up to 31st March, 2018)	Product (₹)
31st May, 2017	600	10	6,000
30th June, 2017	500	9	4,500
31st August, 2017	1,000	7	7,000
1st November, 2017	400	5	2.000
31st December, 2017	1,500	3	4,500
31st January, 2018	300	2	600
1st March, 2018	700	1	700
Total of Products			25,300

Interest on Rakesh's Drawings (By Product Method)

= Total of Product $\times \frac{\text{Rate}}{100} \times \frac{1}{12} = 25{,}300 \times \frac{6}{100} \times \frac{1}{12} =$ ₹126.50

Interest on Rohan's Drawings (By Average Period Method)

= Total Drawings $\times \frac{Rate}{100} \times \frac{6.5}{12} = 4{,}800 \times \frac{6}{100} \times \frac{6.5}{12} =$ ₹156

2.

TABLE SHOWING ADJUSTMENT

Particulars	Kavita (₹)		Meenakshi (₹)		Gauri (₹)		Firm (₹)	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Wrong Appropriation:								
Interest on Capital (2012-13)	12,000	9,600	7,200					28,000
Interest on Capital (2013-14)	12,000		9,600		7,200			28,800
Total (A)	24,000		19,200		14,400			57,600
Correct Appropriation:								
Profit to be credited (2012-13)		14,400		9,600		4,800	28,000	
Profit to be credited (2013-14)		14,400		8,640		5,760	28,800	
Total (B)		28,800		18,240		10,560	57,600	
Net Effect (A – B)	4,800 (Cr.)		960 (Dr.)		3,840 (Dr.)		Nil	

Journal

Particulars		L.F.	Dr. (₹)	Cr. (₹)
2014 April	Meenakshi's Current A/c Dr.		960	
	Gauri's Current A/c Dr.		3,840	
	To Kavita's Current A/c			4,800
	(Adjustment for interest on capital for the years 2012-13 and 2013-14)			

3.

Profit and Loss Appropriation Account
for the year ended 31st March, 2012

Dr. **Cr.**

Particulars		**(₹)**	**Particulars**	**(₹)**
To Interest on Capital			By Profit & Loss A/c (Net Profit)	2,16,000
Ahmad	40,000			
Bheem	30,000			
Daniel	20,000	90,000		
To Salary (to Bheem)		36,000		
To Commission (to Daniel)		12,000		
To Net Profit transferred to:				
Ahmad's Capital A/c				
₹78,000 × 5/10		39,000		
Bheem's Capital A/c				
75,000 × 3/10	23,400			
Add: Transferred from Daniel	1,600	25,000		
Daniel's Capital A/c				
₹78,000 × 2/10	15,600			
Less: Transferred to Bheem	1,600	14,000		
		2,16,000		2,16,000

Working Notes:

(i) Ahmad's Share of Profit is ₹39,000 which is more than guaranteed profit.

Bheem's Share of Profit = ₹78,000 × $\frac{3}{10}$ = ₹23,400.

Bheem's Share of Profit + Interest on Capital = ₹23,400 + ₹30,000 = ₹53,400 Guaranteed Amount = ₹55,000

(ii) Deficiency to be borne by Daniel = ₹55,000 – ₹53,400 = ₹1,600.

4.

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

Particulars	**(₹)**	**Particulars**	**(₹)**
To Manager's Commission (15,000 × 5/100)	750	By Profit b/d (12,500 + 2,500)	15,000
To Profit and Loss Appropriation A/c	14,250		
	15,000		15,000

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

Particulars		**(₹)**	**Particulars**	**(₹)**
To Interest on Capital:			By Profit and Loss A/c	14,250
A (50,000 × 6/100)	3,000			
B (30,000 × 6/100)	1,800	4,800		
To B's Salary A/c		2,500		
To Profits transferred to:				
A's Capital A/c	4,170			
B's Capital A/c	2,780	6,950		
		14,250		14,250

Dr. **Partners' Capital Accounts** **Cr.**

Particulars	**A (₹)**	**B (₹)**	**Particulars**	**A (₹)**	**B (₹)**
To Balance c/d	57,170	37080	By Balance b/d	50,000	30,000
			By Interest on Capital	3,000	1,800
			By Partner's Salary	––	2,500
			By Profit and Loss Appr. A/c	4,170	2,780
	57,170	37,080		57,170	37,080

5. **Profit and Loss Appropriation Account**

for the year ended 31st March, 2018

Dr. **Cr.**

Particulars		(₹)	Particulars		(₹)
To Partners' Current A/cs:			By Profit and Loss A/c (Net Profit)		1,20,000
Shreya	78,508		By Interest on Drawings:		
Vivek	42,992	1,21,500	Shreya	450	
			Vivek	1,050	1,500
		1,21,500			1,21,500

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

Particulars	Shreya (₹)	Vivek (₹)	Particulars	Shreya(₹)	Vivek (₹)
To Balance c/d	3,00,000	2,00,000	By Balance b/d	3,00,000	2,00,000
	3,00,000	2,00,000		3,00,000	2,00,000

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

Particulars	Shreya (₹)	Vivek (₹)	Particulars	Shreya (₹)	Vivek (₹)
To Balance b/d	...	28,000	By Balance b/d	1,00,000	—
To Drawings	12,000	30,000	By P& L Appropriation A/c	78,508	42,992
To Interest on Drawings	450	1,050	By Balance c/d	—	16,058
To Balance c/d	1,66,058				
	1,78,508	59,050		1,78,508	59,050

Working Notes

Particulars	Shreya (₹)	Vivek (₹)
Interest on Capital	24,000	16,000
Salary	60,000	—
Commission	—	30,000
Amount to be paid	84,000	46,000

Total amount to be paid = ₹1,30,000.

Since profits available are less than appropriations, i.e., ₹1,20,000 + ₹1,500 = ₹1,21,500, appropriations will be made to the extent of ₹1,21,500 only in the ratio of 42:23 (84,000:46,000)

Shreya's share = 42/65 × ₹1,21,500 = ₹78,508; Vivek's share = 23/65 × ₹1,21,500 = ₹42,992

6. **Journal**

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2014	Eleen's Capital A/c	Dr.		3,850	
Mar. 31	To Monu's Capital A/c				2,950
	To Ahmad's Capital A/c				900
	(Being the rectifying entry to correct the amounts of profits transferred to Capital Account)				

Working Notes:

1. **Calculation of Opening Capitals and Interest on Capitals:**

Particulars	Eleen (₹)	Monu (₹)	Ahmad (₹)
A. Closing Capitals	1,60,000	1,20,000	80,000
B. *Add:* Drawings already Debited	24,000	24,000	48,000
	1,84,000	1,44,000	1,28,000

C. *Less:* Profit already Credited	20,000	10,000	10,000
D. Opening Capitals	1,64,000	1,34,000	1,18,000
E. Interest on Capitals	₹1,64,000×10/100 = ₹16,400	₹1,34,000×10/100 = ₹13,400	₹1,18,000×10/100 = ₹11,800

2. **Interest on Drawings:**

Eleen = ₹24,000 $\times \frac{5}{100} \times \frac{6.5}{12}$ = ₹650

Monu = ₹24,000 $\times \frac{5}{100} \times \frac{6.5}{12}$ = ₹650

Ahmad = ₹48,000 $\times \frac{5}{100} \times \frac{5.5}{12}$ = ₹1,100

Total Interest on Drawings = ₹2,400

3. **Statement Showing Adjustment**

Particulars	Eleen (₹)		Monu (₹)		Ahmad (₹)		Firm (₹)	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Profits wrongly credited (A)	20,000		10,000		10,000			40,000
Appropriations to be made: (B)								
• Interest on capital (Cr.)		16,400		13,400		11,800	41,600	
• Interest on Drawings (Dr.)	650		650		1,100			2,400
• Divisible profit on 2:2:1		400		200		200	800	
Net effect (A – B)	3,850 Dr.		2,950 Cr.		900 Cr.		NIL	

7.

Dr. Profit and Loss Appropriation Account Cr.

Particulars		(₹)	Particulars	(₹)
To R's Capital A/c (interest on capital)		3,000	By Profit and Loss A/c (net profit)	48,000
To S's Capital A/c (interest on capital)		1,440		
To T's Capital A/c (interest on capital)		1,560		
To Profit transferred to Capital A/cs:				
R	21,000			
Less: Contribution to T	1,000	20,000		
S	12,600			
Less: Contribution to T	600	12,000		
T	8,400			
Add: Contribution by R and S	1,600	10,000		
		48,000		48,000

Working Note:

Deficiency in T's share = 10,000 – 8,400 = ₹1,600

Contribution to T by R = 1,600 $\times \frac{5}{8}$ = ₹1,000; Contribution to T by S = 1,600 $\times \frac{3}{8}$ = ₹600.

8.

Profit and Loss Appropriation Account

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

Particulars		(₹)	Particulars		(₹)
To General Reserve		15,000	By Net Profit		1,50,000
To Salary:			By Interest on Drawings:		
Gambhir	24,000		Gambhir	2,700	
Nihaal	18,000	42,000	Nihaal	2,475	5,175
To Interest on Capital:					
Gambhir	39,600				
Nihaal	29,400	69,000			
To Profit transferred to Current A/cs:					
Gambhir	17,505				
Nihaal	11,670	29,175			
		1,55,175			1,55,175

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

Particulars	Gambhir (₹)	Nihaal (₹)	Particulars	Gambhir (₹)	Nihaal (₹)
To Cash A/c	—	10,000	By Balance b/d	3,00,000	2,50,000
To Balance c/d	***3,60,000***	***2,40,000***	By Cash A/c	60,000	—
	3,60,000	2,50,000		3,60,000	2,50,000

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

Particulars	Gambhir (₹)	Nihaal (₹)	Particulars	Gambhir (₹)	Nihaal (₹)
To Drawings	40,000	40,000	By Salary	24,000	18,000
To Interest on Drawings	***2,700***	***2,475***	By Interest on Capital	39,600	29,400
To Balance c/d	***38,405***	***16,595***	By P & L App. A/c	***17,505***	***11,670***
	81,105	59,070		81,105	59,070

9.

Profit and Loss Appropriation Account

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

Particulars		(₹)	Particulars	(₹)
To Interest on Capitals:			By Profit & Loss A/c	17,200
Amar	1,000			
Akbar	800			
Anthony	200	2,000		
To Anthony's Salary A/c		2,000		
To Akbar's Commission A/c (13,200 × 10/110)		1,200		
To Partners' Capital A/cs (Share in profit):				
Amar	6,000			
Akbar	3,000			
Anthony	3,000	12,000		
		17,200		17,200

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

Particulars	Amar (₹)	Akbar (₹)	Anthony (₹)	Particulars	Amar (₹)	Akbar (₹)	Anthony (₹)
To Drawings A/c	6,000	5,000	4,000	By Balance b/d	20,000	16,000	4,000
To Balance c/d	*21,000*	*16,000*	*5,200*	By Interest on Capital A/c	*1,000*	*800*	*200*
				By Salary A/c	—	—	2,000
				By Commission A/c	—	*1,200*	—
				By P & L Appr. A/c	6,000	3,000	3,000
	27,000	21,000	9,200		27,000	21,000	9,200

10. Profit of ₹45,000 is not adequate to pay Interest on Capital -Anna ₹30,000 and Bobby ₹20,000. Profit of ₹45,000 will be credited to their respective Capital Accounts in the ratio of ₹30,000: ₹20,000, i.e., 3 : 2. Thus, Anna will get ₹27,000 and Bobby will get ₹18,000.