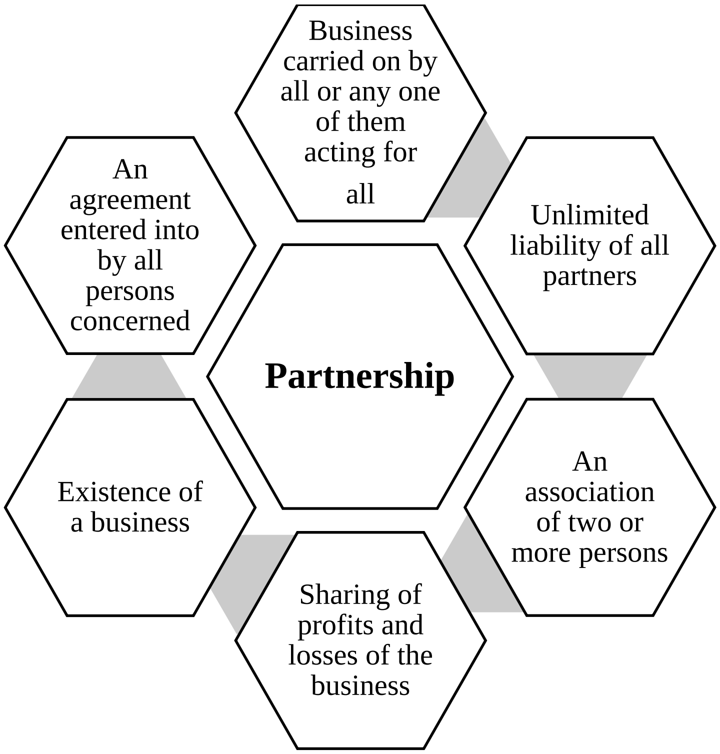
# UNIT-5 FUNDAMENTAL

## UNIT OVERVIEW




| Accounts of Partnership firm | | |
|---|---|---|
| **Trading and Profit and Loss Account and Balance Sheet** | **Profit and Loss Appropriation Account** | **Capital accounts of partners (fixed capital method or fluctuating capital method)** |

## 1. INTRODUCTION: WHY PARTNERSHIP?

An individual i.e., a sole proprietor may not be in a position to cope with the financial and managerial demands of the present day business world. As a result, two or more individuals may decide to pool their financial and non-financial resources to carry on a business. The preparation of final accounts of sole proprietors have already been discussed in chapter 6. The final accounts of partnership firms including basic concepts of accounting for admission of a partner, retirement and death of a partner have been discussed in succeeding units of this chapter.

## 2. DEFINITION AND FEATURES OF PARTNERSHIP

As per **Section 4** of the Partnership Act, 1932:

**"Partnership is the relation between persons who have agreed to share the profit of a business carried on by all or any of them acting for all."**

**Features of a partnership,**

**(i)** **Existence of an agreement:** As per section 5 of the Indian Partnership Act, 1932, The relation of partnership arises from contract between parties and not from status as it happens in case of HUF (Hindu Undivided Family). **A formal or written agreement is not necessary to create a partnership.**

**(ii)** **Business:** A partnership can exist only in business. Thus, it is not the agreement alone which creates a partnership. A partnership comes into existence only when partners begin to carry on business in accordance with their agreement. **Section 2 (b)of Indian Partnership Act, 1932 only states that business includes every trade, occupation and profession.**

**(iii)** **Sharing of profit:** The persons concerned must agree to **share the profits of the business.** Because no person is a partner unless he or she has the right to share the profits of the business. **Section 4 of Indian Partnership Act, 1932** does not insist upon sharing of losses. Thus, a provision for sharing of loss is not necessary.

**(iv)** **Mutual agency:** It means that the business is to be carried on by all or any of them acting for all. Thus, if the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are partners.

**(v)** **Minor as a partner:** A minor can be added in partnership firm. But the condition is that he can be admitted to share profit only. He cannot be made to share losses of the firm. If the partnership firm suffers loss than it will be borne by other major partners is their profit sharing ratio.

**Number of Partners: Minimum Partners: Two**

**Maximum Partners:** As per Section 464 of the Companies Act, 2013, no association or partnership consisting of more than 100 number of persons as may be prescribed shall be formed for the purpose of carrying on any business. Rule 10 of Companies (incorporation) Rules 2014 specifies the limit as 50. Thus, maximum number of members in a partnership firm are 50.

## 3. LIMITED LIABILITY PARTNERSHIP

- The Indian Partnership Act of 1932 establishes a general form of partnership with unlimited liability for all partners, leading to potential personal asset liquidation in case of business debts or legal consequences.
- To promote entrepreneurship and provide an alternative to traditional partnerships, the Limited Liability Partnership (LLP) was introduced in 2008, combining limited liability with a partnership-based organizational structure.
- LLPs are viewed as a separate legal entity, with liability limited to the agreed contributions of its partners, whether tangible or intangible.
- Partners in an LLP are not personally liable for the actions or misconduct of other partners, except in cases of fraudulent intent or misconduct.
- LLPs have the benefit of being taxed as partnerships while enjoying the advantages of being a corporate entity with limited liability.
- LLPs are considered distinct legal personalities, separate from their partners, and operate as a body corporate
- The formation and regulation of LLPs in India are governed by the Limited Liability Partnership Act of 2008.

## 3.1 Definition of LLP

Section 2 of the Limited Liability Partnership (LLPs) Act, 2008 defines **limited liability partnership"** as a partnership formed and registered under this Act; and **"limited liability partnership agreement"** means any written agreement between the partners of the limited liability partnership or between the limited liability partnership and its partners which determines the mutual rights and duties of the partners and their rights and duties in relation to that limited liability partnership.

## 3.2 Non-applicability of the Indian Partnership Act, 1932

Save as otherwise provided, the provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership.

## 3.3 Minimum number of partners in case of LLP

As per the LLP Act, any individual or body corporate may be a partner in a limited liability partnership; provided that an individual shall not be capable of becoming a partner of a limited liability partnership, if-

(a) he has been found to be of unsound mind by a Court of competent jurisdiction and the finding is in force;

(b) he is an undischarged insolvent; or

(c) he has applied to be adjudicated as an insolvent and his application is pending. Every limited liability partnership shall have at least two partners.

If at any time the number of partners of a limited liability partnership is reduced below two and the limited liability partnership carries on business for more than six months while the number is so reduced, the person, who is the only partner of the limited liability partnership during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the limited liability partnership incurred during that period.

# 4. DISTINCTION BETWEEN AN ORDINARY PARTNERSHIP FIRM AND AN LLP

| | **Key Elements** | **Partnerships** | **LLPs** |
|---|---|---|---|
| 1 | Applicable Law | Indian Partnership Act 1932 | The Limited Liability Partnerships Act, 2008 |
| 2 | Registration | Optional | Compulsory with ROC |
| 3 | Creation | Created by an Agreement | Created by Law |
| 4 | Body Corporate | No | Yes |
| 5 | Separate Legal Entity | No | Yes |
| 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 assets. The partners own the assets of the firm | The LLP as an independent entity can own assets |

| | Key Elements | Partnerships | LLPs |
|---|---|---|---|
| 9 | Liability of Partners / Members | Unlimited: Partners are severally and jointly liable for actions of other partners and the firm and their liability extends to personal assets | Limited to the extent of their contribution towards LLP except in case of intentional fraud or wrongful act of omission or commission by a partner. |
| 10 | Principal Agent Relationship | Partners are the agents of the firm and of each other | Partners are agents of the firm only and not of other partners |

However, in the chapter the scope of discussion has been restricted to Partnership accounts as per the Indian Partnership Act, 1932 only.

## 5. MAIN CLAUSES IN A PARTNERSHIP DEED

The relation between the partners is governed by mutual agreement known as partnership deed. It should be comprehensive to avoid disputes later on. It is usual therefore, to find the following clauses in a Partnership Deed which may or may not be registered.

1. Name of the firm and the partners;
2. Commencement and duration of business;
3. Amount of capital to be contributed by each partner;
4. Amount to be allowed to each partner as drawings and the timings of such drawings;
5. Rate of interest to be allowed to each partner on his capital and on his loan to the firm, and to be charged on his drawings;
6. The ratio in which profits or losses are to be shared;
7. Whether a partner will be allowed to draw any salary;
8. Any variations in the mutual rights and duties of partners;
9. Method of valuing goodwill on the occasions of changes in the constitution of the firm;
10. Procedure by which a partner may retire and the method of payment of his dues;
11. Basis of the determination of the executors of a deceased partner and the method of payment;
12. Treatment of losses arising out of the insolvency of a partner;
13. Procedure to be allowed for settlement of disputes among partners;
14. Preparation of accounts and their audit.

Registration of the firm is not compulsory, but non-registration restricts the partners or the firm from taking any legal action. Often there is no written Partnership Deed or, if there is one, it may be silent on a particular point. In that case the relevant sections of the Partnership Act will apply. If on any point the Partnership Deed contains a clause, it will hold good; otherwise the provisions of the Act relating to the questions will apply.

**Rules in the absence of Partnership Deed**

In the absence of any agreement to the contrary;

1. No partner has the right to a salary,
2. No interest is to be allowed on capital,
3. No interest is to be charged on the drawings,

4. Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm, and

5. Profits and losses are to be shared equally.

| |
|---|
| **Note:** In the absence of an agreement, the interest and salary payable to a partner will be paid only if there is profit. |

**Example**

X and Y commenced business in partnership on 1 January 2022. No partnership agreement was made either oral or written. They contributed ₹40,000 and ₹10,000 respectively as capital. In addition, A also advanced ₹20,000 on 1 July 2022. X met with an accident on 1 April 2022 and could not attend to the partnership business upto 30 June 2022. The profits for the year ended on 31 December 2022 amounted to ₹50,600. Disputes having been arisen between them for sharing the profits.

**X claims:** (i) He should be given interest at 10% p.a. on capital and loan (ii) Profit should be distributed in proportion of capital.

**Y claims:** (i) Net profit should be shared equally. (ii) He should be allowed remuneration of ₹1,000 p.m. during the period of A's illness. (iii) Interest on capital and loan should be given @ 6% p.a. You are required to settle the dispute between them and distribute the profits according to law. State reasons for your answer.

**SOLUTION**

Since there is no written or oral partnership agreement, allowing rules are applicable as per Indian partnership act 1932

(a) No interest is allowed on capital.

(b) 6% p.a. interest is allowed on the loan advanced.

(c) Profits and losses shall be shared equally.

(d) No remuneration is allowed to any partner for taking part in the conduct of the business.

Thus

a) neither of A nor B will be allowed interest on capital

b) 6% interest will be allowed to both A and B

c) Profit and losses shall be shared equally between A and B

d) No remuneration shall be allowed to B.

| | | | |
|---|---|---|---|
| Net profit for the year | | = | 50,600 |
| Less: Int. on A's loan 20,000 × 6% × 6/12 | | = | 600 |
| Net Profit | | = | 50,000 |
| X's 50% | 25,000 | | |
| Y's 50% | 25.000 | | |

**Example**

X, Y and Z are partners in a firm sharing profits and losses in the ratio of 2:3:5. Their fixed capitals were ₹15,00,000, ₹30,00,000 and ₹60,00,000 respectively. For the year 2022 interest on capital was credited to them @ 12% instead of 10%. Pass the necessary adjustment entry.

| **Particulars** | **A** | **B** | **C** | **Firm** |
|---|---|---|---|---|
| Interest that should have been credited @ 10% | 1,50,000 | 3,00,000 | 6,00,000 | 10,50,000 |
| Interest already credited @ 12% | 1,80,000 | 3,60,000 | 7,20,000 | 12,60,000 |
| Excess credit in partners account | (30,000) | (60,000) | (1,20,000) | (2,10,000) |
| By recovering the extra amount paid, the share of profits will increase and it will be credited in the ratio of 2:3:5 | 42,000 | 63,000 | 105,000 | 2,10,000 |
| Net effect | 12,000 | 3,000 | (15,000) | - |

The necessary journal entry will be:

| **Particulars** | **Debit (₹)** | **Credit (₹)** |
|---|---|---|
| Z's Capital A/c | 15,000 | |
| To X's Capital A/c | | 12,000 |
| To Y's Capital A/c | | 3,000 |
| (Interest less charged now rectified) | | |

## 6. POWERS OF PARTNERS

According to the Indian Partnership Act, partners have the authority to act in certain matters on behalf of the partnership. Unless there is a public notice stating otherwise, contracts entered into by a partner without consulting other partners are considered binding on the firm. The Act contains provisions that govern such situations and clarify the rights and responsibilities of the partners in this regard.

In case of a trading firm, the implied powers of partners are the following:

(a) Buying and selling of goods;

(b) Receiving payments on behalf of the firm and giving valid receipt;

(c) Drawing cheques and drawing, accepting and endorsing bills of exchange and promissory notes in the name of the firm;

(d) Borrowing money on behalf of the firm with or without pledging the inventories-in-trade;

(e) Engaging servants for the business of the firm.

In certain cases an individual partner has no power to bind the firm. This is to say that third parties cannot bind the firm unless all the partners have agreed. These cases are:

(a) Submitting a dispute relating to the firm arbitration;

(b) Opening a bank account on behalf of the firm in the name of a partner;

(c) Compromise or relinquishment of any claim or portion of claim by the firm;

(d) Withdrawal of a suit or proceeding filed on behalf of the firm;

(e) Admission of any liability in a suit or proceedings against the firm;

(f) Acquisition of immovable property belonging to the firm;

(g) Entering into partnership on behalf of the firm.

The rights, duties and powers of partners can be changed by mutual consent.

## 7. ACCOUNTS

The Partnership Act does not prescribe a specific format for preparing accounts of a partnership firm. Therefore, the accounts are typically prepared following the basic principles of accounting. The accounts of a partnership firm are similar to those of a sole proprietorship, with the main difference being the presence of multiple Capital Accounts for each partner.

If there are multiple partners, each partner will have a separate Capital Account. For example, partners A, B, and C will each have their own Capital Account, which will be credited with the amount they contribute as capital.

When a partner withdraws money from the firm for personal use, there are two ways to record it. The partner's Capital Account can be debited, or a separate account called the Drawings Account can be opened in their name and debited. In a Trial Balance of a partnership firm, you may find both Capital Accounts and Drawings Accounts for each partner. Sometimes, the Drawings Account or Current Account remains separate, while in other cases, the balance of the Drawings Account is transferred to the partner's Capital Account to provide a net figure.

In summary, the accounts of a partnership firm follow general accounting principles, with separate Capital Accounts for each partner and the option to record partner withdrawals in either the Capital Account or a separate Drawings Account.

## 8. PROFIT AND LOSS APPROPRIATION

In a partnership firm, Trading Account and Profit and Loss Account are prepared at the end of each year. The final accounts of a sole proprietorship and a partnership firm do not differ significantly. The Profit and Loss Account shows the profit earned or loss incurred by the firm.

The distribution of profit or loss among the partners is determined by the terms of the Partnership Deed or the provisions of the Indian Partnership Act (if there is no Partnership Deed or it is silent on a specific point). If there is no Partnership Deed, the profit will be divided equally among the partners, regardless of their contributions or involvement in the firm. For example, if there are two partners, A and B, and the profit is ₹90,000, both A and B will receive an equal share.

However, if the Partnership Deed specifies that A is entitled to a salary and interest on capital, those amounts must be deducted from the profit first. The remaining profit is then divided equally between A and B. If the Partnership Deed states a specific profit sharing ratio, such as three-fourths for A and one-fourth for B, that ratio will be followed.

To record the necessary adjustments mentioned in the Partnership Deed, an additional account called the Profit and Loss Appropriation Account is prepared. The net profit is transferred from the debit side of the Profit and Loss Account to the credit side of the Profit and Loss Appropriation Account. This account is used to record adjustments such as interest on capitals, drawings, loans, and salaries or commissions to partners.

If a partner is entitled to a salary, the Profit and Loss Appropriation Account will be debited, and the partner's Capital Account will be credited. Similarly, if interest is to be allowed on capital, the Profit and Loss Appropriation Account will be debited, and the respective Capital Accounts will be credited to reflect the adjustments made before distributing the profits among the partners

Let us take an illustration to understand how to divide profits among partners.

**ILLUSTRATION 1**

C and V start business on 1st January, 2022, with capitals of ₹30,000 and ₹20,000. According to the Partnership Deed, V is entitled to a salary of ₹500 per month and interest is to be allowed on capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2022 the firm earned a profit, before charging salary to B and interest on capital amounting to ₹25,000. During the year C withdrew ₹8,000 and V withdrew ₹10,000 for domestic purposes. Give journal entries relating to division of profit.

**SOLUTION**

**Journal Entries**

| 2022 | Particulars | | Dr. (₹) | Cr. (₹) |
|---|---|---|---|---|
| Dec. 31 | Profit and Loss Appropriation Account | Dr. | 6,000 | |
| | To V's Capital Account | | | 6,000 |
| | (Salary due to B @ ₹500 per month) | | | |
| | Profit and Loss Appropriation Account | Dr. | 3,000 | |
| | To C's Capital Account | | | 1,800 |
| | To V's Capital Account | | | 1,200 |
| | (Interest due on Capital @ 6% per month) | | | |
| | Profit and Loss Appropriation Account | Dr. | 16,000 | |
| | To C's Capital Account | | | 10,000 |
| | To V's Capital Account | | | 6,000 |
| | (Remaining profit of ₹16,000 divide between A and B in the ratio of 5:3) | | | |

Now, let us learn the preparation of profit and loss appropriation account with the help of same illustration of partnership firm consisting of partners C and V.

**ILLUSTRATION 2**

R1, R2 and R3 are partners in a firm. They have no agreement in respect of profit-sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims:

(i) R1, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. But Rahim and Karim do not agree.

(ii) R2 has devoted full time for running the business and demands salary at the rate of ₹500 p.m. But Ram and Karim do not agree.

(iii) R3 demands interest on loan of ₹2,000 advanced by him at the market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to ₹45,000 at the end of the first year of their business

**SOLUTION**

There is no partnership deed. Therefore, the following provisions of the Indian Partnership Act are to be applied for settling the dispute.

(i) No interest on capital is payable to any partner. Therefore, R1 is not entitled to interest on capital.

(ii) No remuneration is payable to any partner. Therefore, R2 is not entitled to any salary.

(iii) Interest on loan is payable @ 6% p.a. Therefore, R3 is to get interest @ 6% p.a. on ₹2,000 instead of 12%.

(iv) The profits should be distributed equally.

**Profit and Loss Appropriation Account for the year ended…**

| | **Particulars** | | ₹ | **Particulars** | ₹ |
|---|---|---|---|---|---|
| To | Interest on R3 Loan A/c | | | By Profit and Loss A/c - | 45,000 |
| | (₹2,000 × 6/100) | | 120 | (Net profit) | |
| To | Reserve A/c – 10% of | | | | |
| | ₹(45,000-120) | | 4,488 | | |
| To | Share of Profit A/c : | | | | |
| | R1 capital A/c | ₹13,464 | | | |
| | R2 capital A/c | ₹13,464 | | | |
| | R3 capital A/c | ₹13,464 | 40,392 | | |
| | | | 45,000 | | 45,000 |

**ILLUSTRATION 3**

Z and X start business on 1st January, 2019, with capitals of ₹30,000 and ₹20,000. According to the Partnership Deed, X is entitled to a salary of ₹500 per month and interest is to be allowed on opening capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2022 the firm earned a profit, before charging salary to X and interest on capital amounting to ₹25,000. During the year A withdrew ₹8,000 and B withdrew ₹10,000 for domestic purposes.

Prepare Profit and Loss Appropriation Account.

**SOLUTION**

**Profit and Loss Appropriation Account for the year ended 31-Dec-22**

| **Particulars** | ₹ | **Particulars** | ₹ |
|---|---|---|---|
| To X's Capital Account-Salary To Z's Capital Account-interest To X's Capital Account-interest To Profit transferred to : | 6,000<br>1,800<br>1,200 | By Net Profit | 25,000 |
| Z's Capital Account (5/8) X's Capital Account (3/8) | 10,000<br>6,000 | | |
| | 25,000 | | 25,000 |

**NOTE:** Since date of drawing & rate of interest on drawing is not given, it is assumed drawings are made on last day of year.

Let us also learn the preparation of capital accounts of partners with the help of same illustration of partnership firm consisting of partners Z and X.

**ILLUSTRATION 4**

A and B start business on 1st January, 2019, with capitals of ₹30,000 and ₹20,000. According to the Partnership Deed, B is entitled to a salary of ₹500 per month and interest is to be allowed on opening capitals at 6% per annum. The remaining profits are to be distributed amongst the partners in the ratio of 5:3. During 2019, the firm earned a profit, before charging salary to B and interest on capital amounting to ₹25,000. During the year A withdrew ₹8,000 and B withdrew ₹10,000 for domestic purposes.

Prepare Capital Accounts of Partners A and B.

**SOLUTION**

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

| **2019** | **Particulars** | **₹** | **2019** | **Particulars** | **₹** |
|---|---|---|---|---|---|
| Dec. 31 | To Bank A/c- (Drawings) | 8,000 | Jan. 1 | By Bank A/c | 30,000 |
| | To Balance c/d | 33,800 | Dec. 31 | By Profit and Loss appropriation A/c Interest | 1,800 |
| | | | | By Profit and Loss appropriation A/c- (5/8 Profit) | 10,000 |
| | | 41,800 | | | 41,800 |
| | | | 2020 | | |
| | | | Jan. 1 | By Balance b/d | 33,800 |

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

| **2019** | **Particulars** | **₹** | **2019** | **Particulars** | **₹** |
|---|---|---|---|---|---|
| Dec. 31 | To Bank A/c- (Drawings) | 10,000 | Jan. 1 | By Bank A/c | 20,000 |
| Dec. 31 | To Balance c/d | 23,200 | Dec. 31 | By Profit and Loss A/c | |
| | | | | - Salary | 6,000 |
| | | | | - Interest | 1,200 |
| | | | | By Profit and Loss A/c | |
| | | | | - (3/8 Profit) | 6,000 |
| | | 33,200 | | | 33,200 |
| | | | 2020 | | |
| | | | Jan. 1 | By Balance b/d | 23,200 |

## 9. FIXED AND FLUCTUATING CAPITAL

You have seen in the above example that the Capital Account of A has changed from ₹30,000 at the beginning to ₹33,800 and B's Capital A/c from ₹20,000 to ₹23,200. This is because we have made entries in respect of interest, salary, profit earned during the year and money taken out by the partners in the Capital Account itself. If the Capital Accounts are prepared on this basis, capitals are said to be fluctuating. Some firms, however, prefer to continue to show the Capital Accounts of the partners at the same old figure. This means that no entry is to be made in the Capital Account in respect of interest, salary, profit and drawings etc. A separate account is to be opened for this purpose. This account is known as the Current Account or even as Drawings Account. Under this system interest on capital if allowed, should be calculated only on the amount of the fixed capital. If the capital Accounts are prepared on this basis, capitals are said to be fixed.

Thus, there are two methods of accounting –

i) **Fixed capital method and**

ii) **Fluctuating capital method.**

**In Fixed capital method,** generally initial capital contributions by the partners are credited to partners' capital accounts and all subsequent transactions and events are dealt with through current accounts, Unless a decision is taken to change it, initial capital account balance is not changed.

**In Fluctuating capital method,** no current account is maintained. All such transactions and events are passed through capital accounts. Naturally, capital account balance of the partners fluctuates every time. So in fixed capital method a fixed capital balance is maintained over a period of time while in fluctuating capital method capital account balances fluctuate all the time.

### 9.1 Interest on Capital:

A partner is not entitled to interest on his capital as a matter of right. But if there is an agreement, that partner would receive interest on his capital it is paid at the agreed rate only out of profits. Interest on capital is generally calculated on the opening balance and allowance is made for any additions of capital or withdrawals there from during the accounting period.

- The amount of interest is debited to interest on capital accounts and credited to the capital accounts, if capitals are fluctuating and current accounts, if capitals are fixed. Interest on capital account is then closed by transfer to profit and loss appropriation account.
- Alternatively, credit the capital (or current) account of the partner concerned and debit the profit and loss appropriation account.

**For interest on capital**

Profit and Loss Appropriation Account Dr.

To (Individual) Capital (or Current) Accounts of Partners

Interest is generally allowed on capitals of the partners. Interest on capital of partners is calculated for the relevant period for which the amount of capital has been used in the business. Normally, it is charged for full year on the balance of capital at the beginning of the year unless some fresh capital is introduced during the year. On the additional capital introduced, interest for the relevant period of utilization is calculated. For example, A has ₹30,000 capital in the beginning of the year and introduces ₹10,000 during the year. If rate of interest on capital is 20 % p.a., interest on A's capital is calculated as follows:

$$\left[30,000 \times \frac{20}{100}\right] + 10,000 \times \left[\frac{20}{100} \times \frac{6}{12}\right] = ₹6,000 + ₹1,000 = ₹7,000$$

In case of fixed capital accounts, interest is calculated on the balance of capital accounts only and no interest is payable / chargeable on the balance of current accounts.

***Net loss and Interest on Capital:*** *Subject to contract between the partners, interest on capitals is to be provided out of profits only. Thus in case of loss, no interest is provided. But in case of insufficient profits (i.e., net profit less than the amount of interest on capital), the amount of profit is distributed in the ratio of capital as partners get profit by way of interest on capital only.*

**Example**

**1.** Shilpa and Sanju are partners with a capital of ₹1,00,000 and ₹1,60,000 on January 1,2019 respectively. Shilpa introduced additional capital of ₹30,000 on July 1, 2019 and another ₹20,000 on October 31,2019. Calculate interest on capital for the year ending 2019. The rate of interest is 9% p.a.

**SOLUTION:**

**Interest on Capital (Shilpa):**

On ₹1,00,000 for 12 month @ 9% = 1,00,000 × 9/100 × 12/12

= ₹9,000

On ₹30,000 for 6 month @ 9% = 30,000 × 9/100 × 6/12

= ₹1,350

On ₹20,000 for 2 month @ 9% = 20,000 × 9/100 × 2/12

= ₹300

Total interest on shilpa capital = ₹9,000 + ₹1350 + ₹300

= ₹10,650

By product method

| **Amount (₹)** | **Months** | **Product** |
|---|---|---|
| 1,00,000 | 12 | 12,00,000 |
| 30,000 | 6 | 1,80,000 |
| 20,000 | 2 | 40,000 |
| Total product | | 14,20,000 |

Interest on capital 14,20,000 × 09/100 × 1/12 = ₹10,650

**Interest on Capital (Sanju):**

On ₹1,60,000 for 12 month @ 9% = 1,60,000 × 9/100 × 12/12 = ₹14,400

By product method: = 1,60,000 × 12 = 19,20,000

$$= 19,20,000 \times \frac{9}{100} \times \frac{1}{12} = 14,400$$

## 9.2 Interest on Drawings

Sometimes interest is not only allowed on the capitals, but is also charged on drawings. In such a case, interest will be charged according to the time that elapses between the taking out of the money and the end of the year.

Method 1: Product Method: When Unequal amount is withdrawn at different time period. Suppose X, a partner, has drawn the following sum of money –

| | ₹ |
|---|---|
| On 29th February, 2020 | 500 |
| On 31st March, 2020 | 400 |
| On 30th June, 2020 | 600 |
| On 31st October, 2020 | 800 |

Accounts are closed on 31st December every year. Interest is chargeable on drawings at 6% per annum. The interest on X's drawings will be calculated as shown below:

| | | ₹ |
|---|---|---|
| 1. | On ₹500 for 10 months, i.e. | 25 |
| 2. | On ₹400 for 9 months, i.e. | 18 |
| 3. | On ₹600 for 6 months, i.e. | 18 |
| 4. | On ₹800 for 2 months, i.e. | 8 |
| | Total | 69 |

Alternatively, it can be calculated as follows:

| Amount (₹) | Number of months | Product |
|---|---|---|
| 500 | 10 | 5,000 |
| 400 | 9 | 3,600 |
| 600 | 6 | 3,600 |
| 800 | 2 | 1,600 |
| 2,300 | | 13,800 |

Interest on ₹13,800 for one month at 6% per annum is ₹69.

If the dates on which amounts are drawn are not given, the student will do well to charge interest for six months on the whole of the amount on the assumption that the money was drawn evenly through out the year. In the above example, the total drawings come to ₹2,300; and at 6% for 6 months, the interest comes to ₹69. The entry to record interest on drawings is- debit the Capital Account of the partner concerned (or his Current Account if the capital is fixed) and credit the Profit and Loss Appropriation Account.

If withdrawals are made evenly in the beginning of each month, interest can be calculated easily for the whole of the amount of 6-1/2 months; if withdrawals are made at the end of each month, interest should be calculated for 5-1/2 months. If withdrawals are mode at the beginning of each quarter, interest can be calculated by Total drawings × Rate × 100 × 7.5/12.

However, if withdrawals are at end of each quarter, the formula : Total drawings × Rate × 100 × 4.5/12 will apply.

## 9.3 Guarantee of Minimum Profit

Sometimes, one partner can enjoy the right to have minimum amount of profit in a year as per the terms of the partnership agreement. In such case, allocation of profit is done in a normal way if the share of partner, who has been guaranteed minimum profit, is more than the amount of guaranteed profit. However, if share of the partner is less than the guaranteed amount, he takes minimum profit and the excess of guaranteed share of profit over the actual share is borne by the remaining partners as per the agreement.

There are three possibilities as far as share of deficiency by other partners is concerned. These are as follows:

- Excess is payable by one of the remaining partners.
- Excess is payable by at least two or all the partners in an agreed ratio.
- Excess is payable by remaining partners in their mutual profit sharing ratio.

If the question is silent about the nature of guarantee, the burden of guarantee is borne by the remaining partners in their mutual profit sharing ratio.

## 9.4 Capital ratio

Partners may agree to share profits and losses in the capital ratio. When capitals are fixed, profits will be shared in the ratio of given capitals. But if capitals are fluctuating and partners introduce or withdraw capitals during the year, the capitals for the purpose of ratio would be determined with reference to time on the basis of weighted average method.

**Example**

A and B formed a partnership with a capital contribution of ₹50,000 and ₹30,000 respectively on 1st January 2019. The profits were to be shared in the capital ratio. Calculate the capital ratio on the basis of following details:

| | **Capital Introduced** | | **Capital Withdrawn** | |
|---|---|---|---|---|
| | **A**<br>₹ | **B**<br>₹ | **A**<br>₹ | **B**<br>₹ |
| 31 March | 5,000 | – | – | 2,000 |
| 1 July | – | 9,000 | 3,000 | – |
| 1 September | 5,500 | – | – | 1,000 |
| 1 November | – | 4,000 | 4,500 | – |

**SOLUTION**

**Total Capital Employed by A for one Month**

| **Capital** | **Months for which capital has been used in the business** | **Product** |
|---|---|---|
| (₹) | | (₹) |
| 50,000 | 3 | 1,50,000 |
| 55,000 | 3 | 1,65,000 |
| 52,000 | 2 | 1,04,000 |
| 57,500 | 2 | 1,15,000 |
| 53,000 | 2 | 1,06,000 |
| Total | | 6,40,000 |

**Total Capital Employed by B for one Month**

| Capital | Months for which capital has been used in the business | Product |
|---|---|---|
| (₹) | | (₹) |
| 30,000 | 3 | 90,000 |
| 28,000 | 3 | 84,000 |
| 37,000 | 2 | 74,000 |
| 36,000 | 2 | 72,000 |
| 40,000 | 2 | 80,000 |
| Total | | 4,00,000 |

On the basis of products of both the partners, the capital ratio between A and B is 64: 40 or 8 : 5.

**ILLUSTRATION 5**

A and B are partners sharing profits and losses in the ratio of their effective capital. They had ₹1,00,000 and ₹ 60,000 respectively in their Capital Accounts as on 1st January, 2019.

A introduced a further capital of ₹10,000 on 1st April, 2019 and another ₹5,000 on 1st July, 2019. On 30th September, 2019 A withdrew ₹40,000.

On 1st July, 2019, B introduced further capital of ₹30,000.

The partners drew the following amounts in anticipation of profit.

A drew ₹1,000 per month at the end of each month beginning from January, 2019. B drew ₹1,000 on 30th June, and ₹5,000 on 30th September, 2019.

12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2019. Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

**SOLUTION**

**(a) Calculation of Effective Capital**

| A | | B | |
|---|---|---|---|
| ₹1,00,000 invested for 3 months i.e., | | ₹60,000 invested for 6 months i.e., | |
| ₹3,00,000 invested for 1 month | 3,00,000 | ₹3,60,000 invested for 1 month | 3,60,000 |
| ₹1,10,000 invested for 3 months i.e., | | ₹90,000 invested for 6 months, i.e., | |
| ₹3,30,000 invested for 1 month. | | ₹5,40,000 invested for 1 month | |
| | 3,30,000 | | 5,40,000 |
| | | | 9,00,000 |
| ₹1,15,000 invested for 3 months i.e., | 3,45,000 | | |
| ₹3,45,000 invested for 1 month. | | | |
| ₹75,000 invested for 3 months, i.e., | | | |
| ₹2,25,000 invested for 1 month. | 2,25,000 | | |
| | 12,00,000 | | |

**(b) Calculation of Interest on Capital**

A = ₹12,00,000 × 12/100 × 1/12 = ₹12,000 B = ₹9,00,000 × 12/100 × 1/12 = ₹9,000

**(c) Calculation of Interest on Drawings**

A = ₹12,000 × 10/100 × 5.5/12 = ₹550 B = ₹1,000 × 10/100 × 6/12 = ₹50

₹5,000 × 10/100 × 3/12 = ₹125

Effective capital is in the ratio 12 : 9 therefore profit sharing ratio is 12 : 9 i.e. 4 : 3.

**ILLUSTRATION 6**

Ram and Rahim start business with capital of ₹50,000 and ₹30,000 on 1st January, 2019. Rahim is entitled to a salary of ₹400 per month. Interest is allowed on capitals and is charged on drawings at 6% per annum. Profits are to be distributed equally after the above noted adjustments. During the year, Ram withdrew ₹8,000 and Rahim withdrew ₹10,000. The profit for the year before allowing for the terms of the Partnership Deed came to ₹30,000. Assuming the capitals to be fixed, prepare the Profit and Loss Appropriation Account and the Capital and Current Accounts relating to the partners.

**SOLUTION**

**Profit & Loss (Appropriation) Account**

| 2019 | Particulars | ₹ | 2019 | Particulars | ₹ |
|---|---|---|---|---|---|
| Dec. 31 | To Rahim's Current A/c | | Dec. 31 | By Net Profit | 30,000 |
| | Salary | 4,800 | | By Sundries-Interest on Drawings: | |
| | To Sundries-Interest on Capitals : | | | Ram's Current A/c (6% on ₹8,000 for 6 months) | 240 |
| | Ram's Current A/c | 3,000 | | Rahim's Current A/c (6% on ₹10,000 for 6 months) | 300 |
| | Rahim's Current A/c | 1,800 | | | |
| | To Profit transferred to | | | | |
| | Ram's Current A/c (1/2) | 10,470 | | | |
| | Rahim's Current A/c (1/2) | 10,470 | | | |
| | | 30,540 | | | 30,540 |

**ILLUSTRATION 7**

With the help of same information given in illustration 6, let us prepare the Capital and Current Accounts of Ram and Rahim.

**SOLUTION**

**Ram's Capital Account**

| 2019 | Particulars | ₹ | 2019 | Particulars | ₹ |
|---|---|---|---|---|---|
| Dec. 31 | To Balance c/d | 50,000 | Jan. 1 | By Bank A/c | 50,000 |
| | | | 2020 | | |
| | | | Jan. 1 | By Balance b/d | 50,000 |

**Rahim's Capital Account**

| 2019 | Particulars | ₹ | 2019 | Particulars | ₹ |
|---|---|---|---|---|---|
| Dec. 31 | To Balance c/d | 30,000 | Jan. 1 | By Bank A/c | 30,000 |
| | | | 2020 | | |
| | | | Jan. 1 | By Balance b/d | 30,000 |

**Ram's Current Account**

| 2019 | Particulars | ₹ | 2019 | Particulars | ₹ |
|---|---|---|---|---|---|
| Dec. 31 | To Cash BankA/C (Drawings) | 8,000 | Dec. 31 | By Profit and Loss appropriation A/c - Interest | 3,000 |
| | To Profit and Loss appropriation A/c - Interest on Drawings | 240 | | By Profit and Loss appropriation A/c - 1/2 profit | 10,470 |
| | To Balance c/d | 5,230 | | | |
| | | 13,470 | | | 13,470 |
| | | | 2020 | | |
| | | | Jan. 1 | By Balance b/d | 5,230 |

**Rahim's Current Account**

| 2019 | Particulars | ₹ | 2019 | Particulars | ₹ |
|---|---|---|---|---|---|
| Dec. 31 | To Cash Bank A/c (Drawings) | 10,000 | Dec. 31 | By Profit and Loss appropriation A/c Salary | 4,800 |
| | | | | Interest | 1,800 |
| | To Profit and Loss appropriation A/c Interest on Drawings | 300 | | By Profit and Loss appropriation A/c Profit | 10,470 |
| | To Balance c/d | 6,770 | | | |
| | | 17,070 | | | 17,070 |
| | | | 2020 | | |
| | | | Jan. 1 | By Balance b/d | 6,770 |

**ILLUSTRATION 8**

A and B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less than ₹250,00,000. Total profits of the firm for the year ended 31st March, 2020 were ₹900,00,000. Calculate share of profits for each partner when:

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by A and B equally.

**SOLUTION**

Case1.When Guarantee is given by firm.

**Profit and Loss Appropriation Account**

**For the year ending on 31st March, 2020**

| **Particulars** | **₹** | **Particulars** | **₹** |
|---|---|---|---|
| To A's Capital A/c (3/5 of ₹650,00,000) | 3,90,00,000 | By Profit and Loss, A/c | 9,00,00,000 |
| To B's Capital A/c (2/5 of ₹650,00,000) | 2,60,00,000 | | |
| To C's Capital A/c (1/6 of ₹9,00,00,000 or ₹25,000,000 which ever is more | 2,50,00,000 | | |
| | 9,00,00,000 | | 9,00,00,000 |

**Case 2.** When Guarantee is given by A

**Profit and Loss Appropriation Account**

**For the year ending on 31st March, 2020**

| **Particulars** | **₹** | **Particulars** | **₹** |
|---|---|---|---|
| To A's Capital A/c (3/6 of ₹9,00,00,000) 4,50,00,000 | | By Profit and Loss, A/c (net profits) | 9,00,00,000 |
| *Less*: Deficiency | | | |
| borne for C (1,00,00,000) | 3,50,00,000 | | |
| To B's Capital A/c (2/6 of ₹9,00,00,000) | 3,00,00,000 | | |
| To C's Capital A/c (1/6 of ₹9,00,00,000) 1,50,00,000 | | | |
| *Add*: Deficiency | | | |
| Recovery from A 1,00,00,000 | 2,50,00,000 | | |
| | 9,00,00,000 | | 9,00,00,000 |

**Case 3.** When Guarantee is given by A and B equally.

**Profit and Loss Appropriation Account**

**For the year ending on 31st March, 2020**

| **Particulars** | | **₹** | **Particulars** | **₹** |
|---|---|---|---|---|
| To A's Capital A/c | | | By Profit and Loss, A/c | 9,00,00,000 |
| (3/6 of ₹9,00,00,000) | 4,50,00,000 | | (net profits) | |
| *Less*: Deficiency borne for C (1/2 of 1,00,00,000) | (50,00,000) | 4,00,00,000 | | |
| To B's Capital A/c | | | | |
| (2/6 of ₹9,00,00,000) | 3,00,00,000 | | | |
| *Less*: Deficiency borne | | | | |

| Particulars | | ₹ | Particulars | ₹ |
|---|---|---|---|---|
| for C (1/2 of 1,00,00,000) | (50,00,000) | 2,50,00,000 | | |
| To C's Capital A/c | | | | |
| (1/6 of ₹9,00,00,000) | 1,50,00,000 | | | |
| *Add*: Deficiency Recovery from A | 50,00,000 | | | |
| *Add*: Deficiency Recovery from B | 50,00,000 | 2,50,00,000 | | |
| | | 9,00,00,000 | | 9,00,00,000 |

**ILLUSTRATION 9**

Aarti, Bharati and Criti were in partnership sharing profits and losses in the ratio 3 : 4 : 3 their capitals as on 1st April 2019 were ₹3,00,000, 5,00,000 and 2,00,000 respectively. According to partnership deed, Criti is entitled to salary of ₹15,000 per month., interest on opening capital is to be allowed @ 12% p.a. Aarti was entitled to rent @ .₹5,000/- per month for premises belonging to her, used for the partnership business. No interest to be charged on drawings. Rent paid to Aarti and salary paid to Criti were debited to drawings account of respective partners. Bharti had withdrawn ₹10,000 per month from the business. The profit of the firm for the year ended 31st March 2020, before charging interest in capital amounted to ₹4,60,000. You are required to prepare Profit and Loss appropriation Account and partners' capital Accounts.

**SOLUTION**

**In the Books of Aarti, Bharti and Criti**

**Profit and Loss Appropriation A/c for the Year ended 31st March 2020**

| Particulars | | ₹ | Particulars | | ₹ |
|---|---|---|---|---|---|
| To salary to Criti | | 1,80,000 | By Net Profit | 4,60,000 | |
| To Interest on capital | | | *Less:* Rent to Aarti | 60,000 | 4,00,000 |
| Aarti | 36,000 | | | | |
| Bharti | 60,000 | | | | |
| Criti | 24,000 | 1,20,000 | | | |
| To Net Profit transferred to | | | | | |
| Aarti | 30,000 | | | | |
| Bharti | 40,000 | | | | |
| Criti | 30,000 | 1,00,000 | | | |
| | | 4,00,000 | | | 4,00,000 |

**Partners' Capital Accounts**

| Particulars | Aarti | Bharti | Criti | Particulars | Aarti | Bharti | Criti |
|---|---|---|---|---|---|---|---|
| | | | | By Balance b/d | 3,00,000 | 5,00,000 | 2,00,000 |
| | | | | By Interest on Capital | 36,000 | 60,000 | 24,000 |
| To Drawings | | 1,20,000 | | By Salary | | | 1,80,000 |
| | | | | By Rent | 60,000 | | |
| | | | | By Profit and loss Appropriation A/c | 30,000 | 40,000 | 30,000 |
| To Balance c/d | 4,26,000 | 4,80,000 | 4,34,000 | | | | |
| | 4,26,000 | 6,00,000 | 4,34,000 | | 4,26,000 | 6,00,000 | 4,34,000 |

**Working Note:**

**Partners Drawings Account**

| Particulars | Aarti | Bharti | Criti | Particulars | Aarti | Bharti | Criti |
|---|---|---|---|---|---|---|---|
| To bank | 60,000 | 1,20,000 | 1,80,000 | By Profit and loss A/c | 60,000 | | |
| | | | | By Profit and loss Appro. A/c | | | 1,80,000 |
| | | | | By Capital A/c | | 1,20,000 | |
| | 60,000 | 1,20,000 | 1,80,000 | | 60,000 | 1,20,000 | 1,80,000 |

**SUMMARY**

- The Indian Partnership Act defines partnership as "the relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all."
- The LLP will be a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature or both tangible and intangible in nature.
- In the partnership firm relations among the partners will be governed by mutual agreement. The agreement is known as Partnership Deed which is to be properly stamped.
- In the absence of an agreement, the interest and salary payable to a partner will be paid only if there is profit.
- During the course of business, a partnership firm will prepare Trading Account and a Profit and Loss Account at the end of every year.
- There are two methods of accounting –

  i. Fixed capital method and

  ii. Fluctuating capital method.

  In fixed capital method, generally initial capital contributions by the partners are credited to partners' capital accounts and all subsequent transactions and events are dealt with through current accounts, Unless a decision is taken to change it, initial capital account balance is not changed.

In fluctuating capital method, no current account is maintained. All such transactions and events are passed through capital accounts. Naturally, capital account balance of the partners fluctuates every time. So in fixed capital method a fixed capital balance is maintained over a period of time while in fluctuating capital method capital account balances fluctuate all the time.

- Interest on capital of partners is calculated for the relevant period for which the amount of capital has been used in the business.
- Subject to contract between the partners, interest on capitals is to be provided out of profits only. Thus in case of loss, no interest is provided. But in case of insufficient profits (i.e., net profit less than the amount of interest on capital), the amount of profit is distributed in the ratio of capital as partners get profit by way of interest on capital only.
- Sometimes, one partner can enjoy the right to have minimum amount of profit in a year as per the terms of the partnership agreement. In such case, allocation of profit is done in a normal way if the share of partner, who has been guaranteed minimum profit, is more than the amount of guaranteed profit. However, if share of the partner is less than the guaranteed amount, he takes minimum profit and the excess of guaranteed share of profit over the actual share is borne by the remaining partners as per the agreement.

## TEST YOUR KNOWLEDGE
## True and False

**1.** In absence of any agreement partners share profits of the business in the ratio of their capital contribution. **(ICAI Study Material)**

**Sol.** **False:** In absence of any agreement partners share profits equally and not in capital contribution ratio.

**2.** Profit sharing ratio and capital contribution ratio need not be same. **(ICAI Study Material)**

**Sol.** **True:** Profit sharing can be different from the that of the capital introduced by each of the partner. Not necessary that partner contributing more capital should have a higher profit sharing ratio and vice versa.

**3.** Every partnership firm must register itself with Registrar of firms. **(ICAI Study Material)**

**Sol.** **False:** Registration of firms is not compulsory under Indian Partnership Act, 1932.

**4.** A partner can advance loan to the partnership firm in addition to capital contributed by him. **(ICAI Study Material)**

**Sol.** **True:** Where the partnership deed is absent, then the interest shall be paid at 6% per annum. So the interest on the loan to be paid to the partner.

**5.** A partner can demand interest on capital even if it is not provided in the partnership deed. **(ICAI Study Material)**

**Sol.** **False:** Interest on capital can be paid only if it is provided in the partnership deed.

**6.** If a partner does not take part in day to day business activities of the firm then he is not entitled to any share of profit. **(ICAI Study Material)**

**Sol.** **False:** Every partner need not take part in the business. Even if a partner does not take part in the business he is entitled for his share of profit.

**7.** Interest should be paid @ 6% p.a. on partners' loan even if it is not provided in the partnership deed. **(ICAI Study Material)**

**Sol.** **True:** In absence of Partnership deed, Interest at the rate of 6%.p.a is to be allowed on a partner's loan to the firm.

**8.** Husband and wife cannot be partners in the same firm. **(ICAI Study Material)**

**Sol.** **False:** Husband and wife can be partners in the same firm.

**9.** One senior partner is Principal and other partners are his agents. **(ICAI Study Material)**

**Sol.** **False:** There is no senior or junior partner. Every partner is agent/principal of other partners.

**10.** Partners are the agents of the firm and each other. **(ICAI Study Material)**

**Sol.** **True:** Concept of agency applies to every partner and the firm as well. So each partner is a principal to and agent of every other partner and to the firm.

**11.** When a partnership firm conducts its business at the location owned by one of the partners, the rental payment is categorized as a distribution of profits.

**Sol.** **False,** The provided statement is incorrect. Even when one of the partners owns the premises, rental expenses are regarded as an expenditure and not as an allocation of profits.

**12.** If there are not enough profits to cover the expenses, even then the "charge" will be there in the Profit & loss.

**Sol.** **True,** If there are not enough profits to cover the expenses, even then the "charge" will be considered

**13.** Interest on loan given by partner to the firm is an appropriation of profit and will be shown in the P/L Appropriation A/c

**Sol.** **False,** Interest on Loan (be it given by an outsider or by any partner) is considered as a charge against profits.

**14.** Interest on drawings is shown on the debit side of the Profit and loss appropriation A/c.

**Sol.** **False,** Interest on drawings is shown on the credit side of the Profit and loss appropriation A/c.

**15.** Interest on drawings is reduced from the capital of the partner (in case of fluctuating capital A/c.)

**Sol.** **True,** Interest on drawings is reduced from the capital of the partner (in case of fluctuating capital A/c)

**16.** Manager's commission is a "charge" on the profits of the Firm and not an appropriation.

**Sol.** **True,** Manager's commission is a charge on the profits of the Firm and not an appropriation.

**17.** If manager's commission is based on certain percentage of profits, then in case of losses, the manager will be sharing in the losses as well.

**Sol.** **False,** If manager's commission is based on certain percentage of profits, then in case of losses, the manager will not be liable for the losses.

**18.** If there are insufficient profits to cover the whole amount of interest on capital of the partners, even then interest on capital will be allocated in full.

**Sol.** **False,** If there are insufficient profits to cover the whole amount of interest on capital of the partners, then interest on capital will be allocated to the extent of the profits available.

**19.** In case of absence of clause in partnership deed, Interest on drawings will be charged.

**Sol.** **False,** In case of absence of clause in partnership deed, Interest on drawings will not be charged.

**20.** In case of absence of clause in partnership deed, partner's salary will be provided.

**Sol.** **False,** In case of absence of clause in partnership deed, Partner's salary will not be provided.

**21.** Husband and Wife cannot be partners in the same firm.

**Sol.** **False:** The given statement is False; Husband and wife can become partners in the firm.

**22**. Dissolution of Partnership firm is same as Dissolution of partnership.

**Sol**. **False:** The given statement is False because the dissolution of a partnership means the end of the partnership agreement and on the other hand the dissolution of a firm means the end of the company's existence.

**23**. Registration of partnership is compulsory.

**Sol**. **False:** Registration of partnership is not compulsory. two or more persons can become partners without getting the firm registered.

**24**. Limited Liability Partnership is illegal in India.

**Sol**. **False:** Limited Liability Partnership is legal in India and it is governed by Limited Liability Partnership Act 2009.

**25**. Is it considered a partnership when two individuals jointly own a property, sell it, and then share the proceeds equally?

**Sol**. **False:** No, it wouldn't be classified as a partnership because, to be considered a partnership, there must be an agreement to engage in a business activity together. Simply selling an asset with shared ownership does not meet the criteria for a partnership.

## Multiple Choice Questions

**1.** If a firm prefers Partners' Capital Accounts to be shown at the amount introduced by the partners as capital in firm then entries for salary, interest, drawings, interest on capital and drawings and profits are made in

(a) Trading Account (b) Profit and Loss Account

(c) Partners' Current Account (d) None of the above **(ICAI Study Material)**

**Sol.** (c) Partners' Current Account

**2.** In the absence of any agreement, partners are liable to receive interest on their Loans @

(a) 12% p.a. (b) 10% p.a. (c) 6% p.a. (d) None of the above

**Sol.** (c) 6% p.a. **(ICAI Study Material)**

**3.** The relationship between persons who have agreed to share the profit of a business carried on by all or any of them acting for all is known as .........

(a) Partnership. (b) Joint Venture.

(c) Association of Persons. (d) None of the above **(ICAI Study Material)**

**Sol.** (c) Association of Persons.

**4.** Firm has earned exceptionally high profits from a contract which will not be renewed. In such a case the profit from this contract will not be included in .........

(a) Profit sharing of the partners. (b) Calculation of the goodwill.

(c) Both. (d) None of the above **(ICAI Study Material)**

**Sol.** (a) Profit sharing of the partners.

**5.** In the absence of an agreement, partners are entitled to

(a) Interest on Loan and Advances. (b) Commission.

(c) Salary. (d) None of the above **(ICAI Study Material)**

**Sol.** (a) Interest on Loan and Advances.

**6.** Partners are supposed to pay interest on drawings only when ......... by the .........

(a) Provided, Agreement. (b) Agreed, Partners

(c) Both (a) & (b) above. (d) None of the above **(ICAI Study Material)**

**Sol.** (c) Both (a) & (b) above.

**7.** When a partner is given a guarantee by the other partner, loss on such guarantee will be borne by

(a) Partner who gave the guarantee (b) All the other partners.

(c) Partnership firm. (d) None of the above **(ICAI Study Material)**

**Sol.** (a) Partner who gave the guarantee

**8.** A, B and C had capitals of ₹50,000; ₹40,000 and ₹30,000 respectively for carrying on business in partnership. The firm's reported profit for the year was ₹80,000. As per provisions of the Indian Partnership Act, 1932, find out the share of each partner in the above amount after taking into account that no interest has been provided on an advance by A of ₹20,000, in addition to his capital contribution.

(a) ₹26,267 for Partner B and C & ₹27,466 for partner A.

(b) ₹26,667 each partner.

(c) ₹33,333 for A, ₹26,667 for B and ₹20,000 for C.

(d) None of the above **(ICAI Study Material)**

**Sol.** (a) ₹26,267 for Partner B and C & ₹27,466 for partner A.

**9.** X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹6,000 and X wanted interest on capital @ 20% as his capital contributions was ₹1,00,000 as compared to that of Y and Z which was ₹75,000 and ₹50,000 respectively.

(a) Profits of ₹6,000 will be distributed equally with no interest on either Capital.

(b) X will get the interest of ₹20,000 and the loss of ₹14,000 will be shared equally.

(c) All the partners will get interest on capital and the loss of ₹39,000 will be shared equally.

(d) None of the above **(ICAI Study Material)**

**Sol.** (a) Profits of ₹6,000 will be distributed equally with no interest on either Capital.

**10.** X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹6,000 and Y determined interest @ 24% p.a. on his loan of ₹80,000. There was no agreement on this point. Calculate the amount payable to X, Y and Z respectively.

(a) ₹2,000 to each partner.

(b) Loss of ₹4,400 for X and Z & Y will take home ₹14,800.

(c) ₹400 for X, ₹5,200 for Y and ₹400 for Z.

(d) None of the above **(ICAI Study Material)**

**Sol.** (c) ₹400 for X, ₹5,200 for Y and ₹400 for Z.

**11.** X, Y and Z are partners in a firm. At the time of division of profit for the year there was dispute between the partners. Profits before interest on partner's capital was ₹6,000 and Z demanded minimum profit of ₹5,000 as his financial position was not good. However, there was no written agreement. Profits to be distributed to X, Y and Z will be

(a) Other partners will pay Z the minimum profit and will suffer loss equally.

(b) Other partners will pay Z the minimum profit and will suffer loss in capital ratio.

(c) ₹2,000 to each of the partners.

(d) None of the above **(ICAI Study Material)**

**Sol.** (c) ₹2,000 to each of the partners.

**12.** The following expenses are considered deductions from profit, with one exception.

(a) Salaries (b) Wages (c) Interest on loan (d) Interest on capital

**Sol.** (d) Interest on capital

**13.** __________ is not a allocation but rather an expense against earnings.

(a) interest on capital (b) Partner's capital (c) Electricity charges (d) None of the above

**Sol.** (c) Electricity charges

**14.** Appropriation of profits is done in

(a) Trading a/c (b) Profit & loss a/c

(c) Profit & loss appropriation a/c (d) Balance sheet

**Sol.** (c) Profit & loss appropriation a/c

**15.** Provisions are created in the

(a) Trading a/c (b) Profit & loss a/c

(c) Profit & loss appropriation a/c (d) Balance sheet

**Sol.** (b) Profit & loss a/c

**16.** Profits are transferred to the Reserves in
(a) Trading a/c (b) Profit & loss a/c
(c) Profit & loss appropriation a/c (d) Balance sheet

**Sol.** (c) Profit & loss appropriation a/c

**17.** If the proprietor is drawing 5000 per month (at the end of each month) then the interest on drawings will be charged for:
(a) 5.5 months (b) 6.5 months (c) 6 months (d) 1 month

**Sol.** (a) If the proprietor is drawing 5000 per month (at the end of each month) then the interest on drawings will be charged for 5.5 Months.

**18.** Manager commission is charged in the
(a) Balance sheet (b) Profit and loss A/c
(c) Profit and loss appropriation A/c (d) None of the above

**Sol.** (b) Manager commission is charged in the Profit and Loss A/c.

**19.** If the proprietor is drawing Rs 10000 per quarter (at beginning of each quarter) then the interest on drawings will be charged for:
(a) 4.5 months (b) 7.5 months (c) 5.5 months (d) 6.5 months

**Sol.** (b) If the proprietor is drawing the same amount at beginning of each quarter then the interest on drawings will be charged for 7.5 months.

**20.** Profit before charging manager's commission amounts to Rs 55000. Manager commission is 10% before charging such commission. Then the amount of manager commission will be
(a) 5000 (b) 5500 (c) 1350 (d) None of the above

**Sol.** (b) Manager commission will be = 55000 * 10/100 = 5500

**21.** Profit before charging manager's commission amounts to Rs 55000. Manager commission is 10% after charging such commission. Then the amount of manager commission will be
(a) 5000 (b) 5500 (c) 1350 (d) None of the above

**Sol.** (a) Manager commission will be = 55000 * 10/110 = 5000

**22.** Which of the following item is not considered while arriving at net profits for the calculation of manager's commission.
(a) Electricity Expenses (b) Wages
(c) Employee's salary (d) Partner's Salary

**Sol.** (d) Because partner's salary will be allocated after the distribution of the manager's commission.

**23.** Calculate manager's commission from the following data.
Commission is 10% of net profit before charging such commission.

| | |
|---|---|
| Gross Profits | 100000 |
| Electricity expenses | 20000 |
| Rent charges | 5000 |
| Interest on capital | 10000 |
| Interest on drawing | 3000 |
| Interest on partner's loan | 5000 |

(a) 7500 (b) 9000 (c) 8000 (d) 7000

**Sol.** (d) Net Profits = 100000 - 20000 - 5000 - 5000 = 70000
Commission = 70000 * 10% = Rs 7000

**24.** Partner's salary is credited to the
(a) Capital A/c / Current A/c (b) Profit and Loss A/c
(c) Profit and Loss Appropriation A/c (d) Salaries A/c

**Sol.** (a) Partner's salary is credited to the Capital A/c of the partner.

**25.** ________ motive should be there for making a partnership firm.

(a) Profit
(b) Social
(c) Both (a) and (b)
(d) None of the above

**Sol.** (a) Profit

**26.** ______ isn't a type of partnership.

(a) Partnership at will
(b) General Partnership
(c) Pvt Ltd Company
(d) Limited Liability Partnership

**Sol.** (c) Pvt Ltd Company

**27.** Following are the features of Partnership.

(a) Two or more persons.
(b) Sharing of profits
(c) Agreement between Partners
(d) All of the above

**Sol.** (d) All of the above

**28.** Following is not an advantage of partnership.

(a) Flexibility
(b) Ease in starting up a firm
(c) Mutual decisions
(d) Unlimited Liability

**Sol.** (d) Unlimited liability

**29.** A partner doesn't has right to:

(a) Access books of accounts
(b) Participate in the profits as per agreed ratio
(c) Participate in managerial decisions
(d) Withdraw amount from other partners' capital

**Sol.** (d) Withdraw amount from other partners' capital

# Theory Questions

**1.** Write short notes on:

(a) Features of Partnership

(b) Powers of Partners **(ICAI Study Material)**

**Sol.**

(a) The following four essential features of a partnership, namely:

(i) Partnership is the result of an agreement: It means that the relation of partnership arises from contract and not from status.

(ii) Business: A partnership can exist only in business.

(iii) Sharing of profit: The persons concerned must agree to share the profits of the business.

(iv) Mutual agency: It means that the business is to be carried on by all or any of them acting for all. Thus, if the person carrying on the business acts not only for himself but for others also so that they stand in the positions of principals and agents, they are partners.

(b) Powers of partners are the following:

(i) Buying and selling of goods;

(ii) Receiving payments on behalf of the firm and giving valid receipt;

(iii) Drawing cheques and drawing, accepting and endorsing bills of exchange and promissory notes in the name of the firm;

(iv) Borrowing money on behalf of the firm with or without pledging the inventories-in- trade;

(v) Engaging servants for the business of the firm.

**2.** Distinguish between

(i) Fixed capital and fluctuating capital.

(ii) Partnership and joint venture **(ICAI Study Material)**

**Sol.**

(a) In fixed capital method, generally initial capital contributions by the partners are credited to partners' capital accounts and all subsequent transactions and events are dealt with through current accounts, Unless a decision is taken to change it, initial capital account balance is not changed.

In fluctuating capital method, no current account is maintained. All such transactions and events are passed through capital accounts. Naturally, capital account balance of the partners fluctuates every time. So in fixed capital method a fixed capital balance is maintained over a period of time while in fluctuating capital method capital account balances fluctuate all the time.

(b) Partnership is a relationship between persons who have agreed to share profits or losses of a business carried on by all or any of them acting for all. Whereas, a joint venture is a contractual agreement whereby two or more parties undertake an economic activity which is subject to joint control. Thus joint venture is a temporary partnership formed for a particular economic activity or venture. The following differences exist between joint venture and other forms of partnership:

The owners of a partnership business are called partners, whereas the owners of a joint venture are called co-ventures.

Accrual basis of accounting is followed in case of partnership and a joint venture generally follows cash basis of accounting.

The financial results of a partnership are obtained at regular intervals. On the other hand, the financial results of a joint venture are obtained generally at the end of the venture.

However, there may be ventures in certain areas which may last for a longer period, for example, joint ventures in key areas like power, petroleum, telecommunication, etc. In these cases, the ventures may even last for ten/fifteen years. For these long term joint ventures, financial statements are prepared periodically by following accrual basis of accounting. Therefore, the line of distinction between long term joint ventures and other forms of partnership is very thin.

**3.** Write down a short note on "charge on profits" and "appropriations of profits".

**Sol.** **Charge:** A charge denotes the costs that must be settled regardless of whether the firm is profitable. Even in the case of losses, these expenses are obligated to be paid and are recorded on the debit side of the profit and loss account.

**Appropriations of profits:** Appropriations do not constitute expenses; instead, they represent a portion of the profits. Appropriations involve the allocation of profits to reserves or partners, which can include items like salaries, interest on capital, and the remaining net profits, typically accounted for through a profit and loss appropriation account.

**4.** What are the different types of partnerships?

**Sol.** Here are the various types of partnerships:

1. General Partnership: In a general partnership, the partnership agreement involves partners with unlimited liability (except for minor partners). All partners have control over business activities, and rights and responsibilities are equally distributed among them.
2. Limited Partnership: This partnership type features partners with mixed liability. Some partners have limited liability, while others have unlimited liability. Partners with limited liability typically have less influence over business operations and mainly contribute capital while sharing in profits.
3. Limited Liability Partnership (LLP): In India, the Limited Liability Partnership Act of 2009 defines this partnership structure. LLPs can have an unlimited number of partners, and all partners maintain unlimited liability.
4. Partnership at Will: Partnership at will refers to a partnership where there is no specific clause in the agreement specifying when the partnership will expire. Even if the fixed period of the partnership has concluded, as long as business activities continue, it is considered a "partnership at will.

**5.** Write a short note on "Rights of a minor partner".

**Sol.** Rights of a minor partner include:

1. Entitlement to share in the firm's profits without bearing any liability for its losses.
2. The right to inspect the firm's financial records and request a copy of the accounts.
3. Upon reaching the age of 18, the minor partner has six months to decide whether to continue with the partnership by issuing a public notice.
4. The ability to take legal action against other partners to claim their share of profits in the partnership

**6.** Define:

1. Dissolution of partnership
2. Dissolution of Partnership Firm.

**Sol.** **Dissolution of Partnership:** When partners opt to reconfigure their partnership by altering the relationships among them and creating a new partnership agreement, leading to the conclusion of the previous partnership agreement, it is referred to as the termination of partnership.

**Dissolution of Partnership Firm:** The dissolution of a partnership firm occurs when the partnership firm itself ceases to exist, resulting in the permanent cessation of its business activities.

# Practical Questions

**1.** Weak, Able and Lazy are in partnership sharing profits and losses in the ratio of 2:1:1. It is agreed that interest on capital will be allowed @ 10% per annum and interest on drawings will be charged @ 8 % per annum. (No interest will be charged/allowed on Current Accounts).

The following are the particulars of the Capital and Drawings Accounts of the partners:

| | **Weak** | **Able** | **Lazy** |
|---|---|---|---|
| | **₹** | **₹** | **₹** |
| Capital (1.1.2019) | 75,000 | 40,000 | 30,000 |
| Current Account (1.1.2019) | 10,000 | 5,000 | (Dr.) 5,000 |
| Drawings | 15,000 | 10,000 | 10,000 |

The draft accounts for 2019 showed a net profit of ₹60,000 before taking into account interest on capitals and drawings and subject to following rectification of errors:

(a) Life Insurance premium of Weak amounting to ₹750 paid by the firm on 30th June, 2019 has been charged to Miscellaneous Expenditure A/c.

(b) Repairs of Machinery amounting to ₹10,000 has been debited to Plant Account and depreciation thereon charged @ 20%.

(c) Travelling expenses of ₹3,000 of Able for a pleasure trip to U.K. paid by the firm on 30th June, 2019 has been debited to Travelling Expenses Account.

You are required to prepare the Profit and Loss Appropriation Account, Current Accounts of partners Weak, Able and Lazy for the year ended 31st December, 2019. **(ICAI Study Material)**

**Sol.**

**Weak, Able & Lazy**

**Profit and Loss Appropriation Account for the year ended**

**31st December, 2019**

| | **₹** | **₹** | | **₹** | **₹** |
|---|---|---|---|---|---|
| To Interest on Capital: | | | By Net Profit (Adjusted) | | 55,750 |
| Weak | 7,500 | | By Interest on Drawings: | | |
| Able | 4,000 | | Weak | 630 | |
| Lazy | 3,000 | 14,500 | Able | 520 | |
| | | | Lazy | 400 | 1,550 |
| To Partner's Current A/cs - | | | | | |
| Share of profit : | | | | | |
| Weak | 21,400 | | | | |
| Able | 10,700 | | | | |
| Lazy | 10,700 | 42,800 | | | |
| | | 57,300 | | | 57,300 |

**Working Notes:**

**(i) Adjusted Profit**

| | ₹ | ₹ |
|---|---|---|
| Net Profit as per Profit & Loss A/c | 60,000 | |
| *Add* : Drawings by Weak : Life Insurance Premium of Weak charged to Miscellaneous Expenditure A/c of the Firm | 750 | |
| Drawings by Able : Travelling expenses of Able in connection with pleasure trip to U.K. charged to travelling expenses A/c of the firm | 3,000 | 63,750 |
| *Less*: Repairs to Machinery wrongly capitalised | 10,000 | |
| *Less* : Depreciation charged @ 20% | (2,000) | (8,000) |
| | | 55,750 |

**(ii) Interest on Drawings :**

| | Weak | Able | Lazy |
|---|---|---|---|
| | ₹ | ₹ | ₹ |
| Drawings | 15,000 | 10,000 | 10,000 |
| *Add* : Rectification adjustments | 750 | 3,000 | – |
| | 15,750 | 13,000 | 10,000 |
| Interest @ 8% p.a. for 6 months | 630 | 520 | 400 |

**Partners' Current Accounts**

| | Weak | Able | Lazy | | Weak | Able | Lazy |
|---|---|---|---|---|---|---|---|
| | ₹ | ₹ | ₹ | | ₹ | ₹ | ₹ |
| To Balance b/d | – | – | 5,000 | By Balance b/d | 10,000 | 5,000 | – |
| To Drawings | 15,000 | 10,000 | 10,000 | By Profit & Loss App. A/c (Int. on capital) | 7,500 | 4,000 | 3,000 |
| To Life Insurance Premium | 750 | – | – | By Profit & Loss App. A/c (Share of profit) | 21,400 | 10,700 | 10,700 |
| To Travelling Expenses. | – | 3,000 | – | | | | |
| To Profit & Loss App. A/c (Int. on drawings) | 630 | 520 | 400 | | | | |
| To Balance c/d | 22,520 | 6,180 | – | By Balance c/d | – | – | 1,700 |
| | 38,900 | 19,700 | 15,400 | | 38,900 | 19,700 | 15,400 |

2. Ram and Rahim are in partnership sharing profits and losses in the ratio of 3:2. As Ram, on account of his advancing years, feels he cannot work as hard as before, the chief clerk of the firm, Ratan, is admitted as a partner with effect from 1st January, 2019, and becomes entitled to 1/10th of the net profits and nothing else, the mutual ratio between Ram and Rahim remaining unaltered.

Before becoming a partner, Ratan was getting a salary of ₹500 p.m. together with a commission of 4% on the net profits after deducting his salary and commission.

It is provided in the partnership deed that the share of Ratan's profits as a partner in excess of the amount to which he would have been entitled if he had continued as the chief clerk, should be taken out of Ram's share of profits.

The net profit for the year ended December 31, 2019 is ₹1,10,000. Show the distribution of net profit amongst the partners. **(ICAI Study Material)**

**Sol.**

**Amount due to Ratan as a Chief Clerk**

| | ₹ |
|---|---|
| Salary | 6,000 |
| *Add*: Commission 4/104 (₹1,10,000 - ₹6,000) | 4,000 |
| | 10,000 |
| *Less*: Share of Profit as a partner (1/10th of 1,10,000) | (11,000) |
| Excess chargeable to Ram | (1,000) |

**Profit and Loss Appropriation Account for the year ended December 31,2019**

| | **Particulars** | **₹** | **Particulars** | **₹** |
|---|---|---|---|---|
| To | Share of Profit A/c | | By Profit and Loss A/c | |
| | Ram [3/5 of (₹1,10,000 – ₹10,000) – ₹1,000] | 59,000 | (Net profit) | 1,10,000 |
| | Rahim [2/5 of (₹1,10,000 – ₹10,000)] | 40,000 | | |
| | Ratan [1/10 of ₹1,10,000] | 11,000 | | |
| | | 1,10,000 | | 1,10,000 |

**3.** X and Y are partners. As per terms of agreement interest is allowed on capital at 8% p.a. and charged on drawings at 10% p.a. X withdrew ₹40,000 pm at the end of each month and Y withdrew ₹120,000 at the end of each quarter. You are required to fill the missing figures in following accounts:

**Profit and Loss Appropriation Account for the year ended March 31, 2020**

| **Particulars** | | **₹** | **Particulars** | | **₹** |
|---|---|---|---|---|---|
| To …? | | | By Profit and Loss A/c (Net profit) | | ? |
| To Interest on Capital A/c | | | By Interest on Drawings A/c | | |
| X | 160,000 | | X | ? | ? |
| Y | ? | 288,000 | Y | ? | |
| To profit transferred to Capital A/c | | | | | |
| X (2/3) | ? | | | | |
| Y (1/3) | 280,000 | ? | | | |
| | | ? | | | ? |

**Partner's Capital Accounts**

| Particulars | X | Y | Particulars | X | Y |
|---|---|---|---|---|---|
| To …? | ? | ? | By …? | ? | ? |
| To …? | ? | ? | By Salary A/c | 3,60,000 | ? |
| To …? | ? | ? | By …? | ? | |
| | | | By …? | ? | ? |
| | ? | ? | | ? | ? |

**(ICAI Study Material)**

**Sol.**

**Profit and Loss Appropriation Account for the year ended March 31, 2020**

| Particulars | ₹ | Particulars | ₹ |
|---|---|---|---|
| To Salary to X | 3,60,000 | By Profit and Loss A/c (Net profit) | 14,48,000 |
| To Interest on Capital A/c | | By Interest on Drawings A/c | 40,000 |
| X 1,60,000 | | X 22,000 | |
| Y 1,28,000 | 2,88,000 | Y 18,000 | |
| To profit transferred to Capital A/c | | | |
| X (2/3) 5,60,000 | | | |
| Y (1/3) 2,80,000 | 8,40,000 | | |
| | 14,88,000 | | 14,88,000 |

**Partner's Capital Accounts**

| Particulars | X | Y | Particulars | X | Y |
|---|---|---|---|---|---|
| To Drawing A/c | 4,80,000 | 4,80,000 | By Balance b/d | 20,00,000 | 16,00,000 |
| To Interest on Drawings A/c | 22,000 | 18,000 | By Salary A/c | 3,60,000 | 1,28,000 |
| To Balance c/d | 25,78,000 | 15,10,000 | By Interest on Capital A/c | 1,60,000 | |
| | | | By Profit and Loss App A/c | 5,60,000 | 2,80,000 |
| | 30,80,000 | 20,08,000 | | 30,80,000 | 2,008,000 |

Working Notes:

1. X's Share of Profit 2,80,000 × 3/1 × 2/3 = 5,60,000
2. Interest on Drawings

   X = 4,80,000 × 11/2 × 1/12 × 10/100 = 22,000 Y = 4,80,000 × 9/2 × 1/12 × 10/100 = 18,000
3. Y's Interest on Capital 2,88,000 – 1,60,000 = 128,000

**4.** Consider following items and name the category (charge against profits/ appropriations of profits)

1. Stationary Expenses
2. Wages
3. Partner's Loan Interest
4. Partner's Salary
5. Partner's Interest on capital
6. Partner A's Husband Salary
7. Partner B's Wife Salary
8. Partner's Wife Loan to the firm

**Sol.**

| | | | |
|---|---|---|---|
| 1. | Stationary Expenses | - | Charge against Profits |
| 2. | Wages | - | Charge against Profits |
| 3. | Partner's Loan Interest | - | Charge against Profits |
| 4. | Partner's Salary | - | Appropriations of Profits |
| 5. | Partner's Interest on capital | - | Appropriations of Profits |
| 6. | Partner A's Husband Salary | - | Charge against Profits |
| 7. | Partner B's wife salary | - | Charge against Profits |
| 8. | Partner's Wife Loan to the firm | - | Charge against Profits |

**5.** P and Q started business on 1/4/2021, with capitals of Rs 40000 and 50000. As per Partnership Deed, Q is entitled to a salary of Rs 700 per month and interest is to be allowed on opening capitals at 8% per annum. The remaining profits are to be distributed to the partners in 5:3. During the year firm earned a profit, before charging salary to Q and interest on capital amounting to Rs 50,000. During the year P withdrew Rs 10,000 and Q withdrew Rs 15,000 for personal expenditures. Prepare Profit and Loss Appropriation A/c.

**Sol.**

**Profit & Loss Account Appropriation A/c.**

| Particulars | Amount | Particulars | Amount |
|---|---|---|---|
| To Q's Capital- Salary<br>To P's Capital- Interest<br>To Q's Capital-Interest<br>To Profit transferred to:-<br>A's capital account(5/8)<br>B's capital account(3/8) | 8400<br>3200<br>4000<br><br><br>21500<br>12900 | By Net Profit | 50000 |
| | 50000 | | 50000 |

**NOTE:** Since date of drawing & rate of interest on drawing is not given, it is assumed drawings are made on last day of year.

**6.** A, B and C are partners in a firm. They have no agreement in respect of profit-sharing ratio, interest on capital, interest on loan advanced by partners and remuneration payable to partners. In the matter of distribution of profits they have put forward the following claims:

(i) A, who has contributed maximum capital demands interest on capital at 12% p.a. and share of profit in the capital ratio. But B and C do not agree.

(ii) B has devoted full time for running the business and demands salary at the rate of 20000 p.m. But A and C do not agree.

(iii) C demands interest on Loan @ 12% (loan Loan advanced = 4,000)

How shall you settle the dispute and prepare Profit and Loss Appropriation Account after transferring 10% of the divisible profit to Reserve. Net profit before taking into account any of the above claims amounted to ₹ 40,000 at the end of the first year of their business.

**Sol.** There is no partnership deed. Therefore, the following provisions of the Indian Partnership Act are to be applied for settling the dispute.

(i) No interest on capital is payable to any partner. Therefore, A is not entitled to interest on capital.

(ii) No remuneration is payable to any partner. Therefore, B is not entitled to any salary.

(iii) Interest on loan is payable @ 6% p.a. Therefore, C is to get interest @ 6% p.a. on Rs. 4,000 instead of 12%.

(iv) The profits should be distributed equally.

**Profit and loss appropriation account**

| **Particulars** | **Amount** | | **Amount** |
|---|---|---|---|
| To C's interest on Loan (4000*6/100)<br>To Reserve A/c<br>10% of (40000-240)<br>A 13253<br>B 13253<br>C 13254 | 240<br><br><br><br><br><br>39760 | By Net Profits | 40000 |

**7.** Mr. A, B And C are partners in a firm sharing profits and losses equally.

They are drawing the following amounts.

Mr A - Rs 5000 (middle of every month)

Mr B - Rs 7000 (Begining of every month)

Mr C - Rs 9000 (at the end of each month)

You are required to calculate interest on drawings @ 10%

**Sol.** Interest on drawings will be calculated as follows :-

Mr A- Drawings will be charged for 6 months {(11.5+0.5)/2}

So the interest on drawings will be = 5000*12 * 6/12 * 10/100 = Rs 3000

Mr B- Drawings will be charged for 6.5 months {(12+1)/2}

So the interest on drawings will be = 7000*12 * 6.5/12 * 10/100 = 4550

Mr C- Drawings will be charged for 5.5 Months {(11+0)/2}

So the interest on drawings will be = 9000*12 * 5.5/12 * 10/100 = 4950

**8.** Mr. A, B And C are partners in a firm sharing profits and losses equally.

They are drawing the following amounts from their capital

Mr A - Rs 5000 (middle of every quarter)

Mr B - Rs 7000 (Begining of every quarter)

Mr C - Rs 9000 (at the end of each quarter)

You are required to calculate interest on drawings @ 10%

**Sol.** Interest on drawings will be calculated as follows :-

Mr A- Drawings will be charged for 6 months {(10.5+1.5)/2}

So the interest on drawings will be = 5000*4 * 6/12 * 10/100 = Rs 1000

Mr B- Drawings will be charged for 7.5 months {(12+3)/2}

So the interest on drawings will be = 7000*4 * 7.5/12 * 10/100 = 1750

Mr C- Drawings will be charged for 4.5 Months {(9+0)/2}

So the interest on drawings will be = 9000*4 * 4.5/12 * 10/100 = 1350

**9.** X and Y are partners of a firm, at the end of the year, Net profits were 70000. and Interest on capital to be provided to X was 50000 and Y's Salary was 90000. Capital of X is 200000 and that of Y is 500000.

Calculate the allocations to be made to both partners.

**Sol.** Since the allocations are more than profits.

I.E (50000+90000) > 70000

Then the profits will be distributed in the ratio of appropriations,

here ratio will be

X : Y

50000 : 90000

5 : 9

**Profit and loss appropriation account**

| Particulars | Amount | Particulars | Amount |
|---|---|---|---|
| To X's Capital A/c (5/14)<br>To Y's Capital A/c (9/14) | 25000<br>45000 | By Net Profits | 70000 |

❑❑❑