Unit 1: INTRODUCTION TO PARTNERSHIP ACCOUNTS

CH 10A

"Your problem isn't the problem. Your reaction is the problem. You can do anything, but not everything."

DEFINITIONS

Partnership	Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all.
Partners	Persons who have entered into Partnership with one another are individually called Partners.
Firm	Persons who have entered into Partnership with one another are collectively called firm
Firm Name	The name under which their business is carried on is called the Firm Name

FEATURES OF PARTNERSHIP

Persons	It requires at least two persons to form a Partnership.
Agreement	An agreement is entered by all the persons concerned, setting out the terms and conditions under which the Partnership is based. When this agreement is set out in writing, it is called the "Partnership Deed".
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
Mutual Agency	The activities of the business will be carried on/managed by all or any one of them acting for all. This principle of mutuality is the essence of Partnership agreement
Sharing of Profit/loss	The Partners share the profits and losses of the business in the agreed ratio.
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.

Number of Partners:
Minimum Partners: Two
Maximum Partners: As per Section 464 of Companies Act, 2013, no association or partnership consisting of more than such number of persons as may be prescribed shall be formed for the purpose of carrying on any business which shall not exceed 100. Prescribed limit is 50. Thus, maximum number of members in a partnership firm are 50.

PARTNERSHIP DEED & CONTENTS

Meaning	Partnership Deed is the written agreement containing the terms and conditions under which the Partnership will sustain or exist.

Contents of Partnership Deed	❖ Name of the firm and the nature of the Partnership Business. ❖ Commencement and Tenure of the Business (e.g. Partnership at Will, etc.) ❖ Amount of Capital to be contributed by each Partner. ❖ Ratio for sharing the Profit/Loss of Partnership business. ❖ Arrangement in respects of Drawings by Partners and limits thereon. ❖ Interest to be credited on the Capital Account of Partners. ❖ Interest to be charged on Drawings of Partners ❖ Remuneration to Partners & the basis of determining such remuneration e.g. Commission as a percentage of Firm's Turnover, other conditions etc. ❖ Process of setting disputes that may arises among the Partners. ❖ Procedure for maintenance of Books of Accounts ❖ Audit of Books of Accounts ❖ Manner of valuation of Goodwill in case of admission of new partners, retirement of existing partners and death of a Partner. ❖ Procedure for settlement of Partners' claims in case of retirement/death ❖ Procedure for dissolution of Partnership
Notes	❖ When partnership deed is not registered a partnership firm is allowed to carry on business subject to certain disabilities. ❖ It is not mandatory to have a written agreement in all cases. Further, even in cases where there is a written Partnership Deed, it is not compulsory to have it registered.

DISTINCTION BETWEEN PARTNERSHIP & LIMITED LIABILITY PARTNERSHIP

BASIS	PARTNERSHIP	LIMITED LIABILITY PARTNERSHIP
Applicable Law	Indian Partnership Act 1932	The Limited Liability Partnerships Act, 2008
Registration	Optional	Compulsory
Creation	Created by an Agreement	Created by Legal process
Separate Legal Entity	No	Yes
Body Corporate	No	Yes
Name	No guidelines. The partners can have any name as per their choice	Name of LLP to contain word limited liability partners (LLP) as suffix.
Perpetual Succession	Partnerships do not have perpetual succession	It has perpetual succession and individual partners may come and go
Number of Partners	Minimum 2 and Maximum 50	Minimum 2 but no maximum limit
Designated Partners	There is no provision for such partners under the Partnership Act, 1932.	At least two designated partners and atleast one of them shall be resident in India.
Legal compliances	All partners are responsible for all the compliances and penalties under the Act.	Only designated partners are responsible for all the compliances and penalties under this Act
Liability of Partners / Members	Liability of each partner is unlimited. It can be extended upto the personal assets of the partners.	Liability of each partner limited to the extent to agreed contribution except in case of willful fraud.

POWERS OF PARTNERS

- ❖ Buying and selling of goods;
- ❖ Receiving payments on behalf of the firm and giving valid receipt;
- ❖ Drawing cheques and drawing, accepting and endorsing bills of exchange and promissory notes in the name of the firm;
- ❖ Borrowing money on behalf of the firm with or without pledging the inventories-in-trade;
- ❖ Engaging servants for the business of the firm.

REMUNERATION, INTEREST ON CAPITAL, LOAN, DRAWINGS, PROFIT SHARING RATIO

1. Governing Statute: The law governing Partnership in India is the Partnership Act, 1932.
2. Conditions not covered by Partnership Deed: Where any situation or circumstance is not covered by the Partnership Deed or is not adequately provided for in the Partnership Deed, the Provision of the Partnership Act, 1932 will apply.

If the Deed is silent on-	Provisions of the Partnership Act
Partners' Remuneration/ Salary/Commission	No Remuneration will be allowed.
Interest on Partners' Capital	No IOC will be allowed to any Partner.
Interest on loan given by Partner to Firm	Maximum 6% p.a. can be allowed on loan.
Interest on Partners' Drawings	No interest will be charged.
Profit Sharing Ratio	Profits and Losses will be shared equally.

PARTNER'S CAPITAL ACCOUNTS

1. Transactions: The following transactions affect the Capital Accounts of Partners-
   - (a) Capital Contribution in the form of Cash/ other Asset introduced into business. (Both Initial Capital Contribution & Additional Capital Contribution, to the extent not treated as Loan, will be considered.)
   - (b) Interest on Capital at the rate agreed in the Partnership Deed,
   - (c) Amounts withdrawn by Partners during the period.
   - (d) Interest, if any, chargeable on Drawings of partners.
   - (e) Salary/ Remuneration to Partners for managing the affairs of the business,
   - (f) Share of Profit / loss of the business as per agreed Profit Sharing Ratio (PSR)

2. Methods of Accounting: The transactions affecting the Partners' Capital Accounts may be accounted under any of the following methods-

Aspects	Fluctuating Capital Method	Fixed Capital Method
Ledger A/cs prepared	Partner's Capital Account.	1. Partner's Capital Account, and 2. Partner's Current Account.
Initial Capital contribution	Amount brought in or contribution is credited to Partner's Capital A/c	Amount brought in or contributed is credited to Partners' Capital A/c
Subsequent transactions	Subsequent transactions are accounted in Partner's Capital A/c	Subsequent transactions are accounted in Partner's Current A/c

FORMAT OF PARTNER'S CAPITAL ACCOUNT

Particulars	A	B	C	Particulars	A	B	C
To Cash/Bank (Withdrawal of capital, if any) To Balance c/d				By Balance b/d By Cash/ Bank/ Assets (Capital Contribution)			
Total				Total			

FORMAT OF PARTNER'S CURRENT ACCOUNT

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d				By Balance b/d			
To Drawings A/c				By P&L Appropriation			
To P&L A/c				-Remuneration/ Salary etc.			
- Share of Loss				-Interest on Capital			
To P&L Appropriation				-Share of Profit			
-Interest on Drawings							
To Balance c/d				By Balance c/d			
Total				Total			

Note: If Capital Accounts are maintained on Fluctuating basis, all the above entries will be made in one single Capital Account only. There will not be any Current Account.

PROFIT & LOSS APPROPRIATION ACCOUNT

1. Purpose: Profit & Loss A/c of firm will show the profit earned or loss suffered by the firm. To distribute the Profit properly to the Partners, the Profit & Loss Appropriation A/c is used

2. Features:
   (a) It is an extension of P&L Account.
   (b) It is applicable only for Partnership Firm, and not Sole Proprietary Concerns.
   (c) It provides details of how Net Profit for the period has been distributed to the Partners.
   (d) The entries in P&L Appropriation A/c are governed by the Partnership Deed.

Note: Interest on Partners' Loan, Rent for use of Partners' premises, if any, etc. are debited to P&L A/c itself. Net Profit after charging and debiting these items, is only transferred to P&L Appropriation A/c.

3. Format:

Dr. Profit & Loss Appropriation A/c Cr.

Particulars	Amount ₹	Particulars	Amount ₹
To Interest on partner's capital	XX	By P&L A/c balance (Profit)	XX
A ---		By Interest on partner'sdrawings	XX
B ---		A ---	
To Partner's Salary	XX	B ---	
A ---			
B ---			
To Partner's Commission/Bonus	XX		
A ---			
B ---			
To Reserves (Amount transferred)	XX		
To Profits transferred in PSR:	XX		
A ---			
B ---			
Total	XXXX	Total	XXXX

CALCULATION OF REMUNERATION / SALARY / COMMISSION TO PARTNERS

Remuneration/ Salary/ Commission to Partners, can be provided to Partners, only if the Partnership Deed so provides. The calculations are as under:-

Type of Capital	Computation
1. Remuneration/ Salary	Remuneration / Salary p.a. = Monthly Amount x No. of months
2. Commission as x % of Turnover	Commission p.a. = Sales Turnover of the Firm x Rate of Commission
3. Commission as x % of Net Profit (a) Before Commission (b) After Commission	 Net Profit before Commission x Rate of Commission /100 Net Profit before Commission x $\frac{\text{Rate of Commission}}{(100+\text{Rate of Commission})}$

Example:

Net Profit for the year before Manager's Commission amounted to ₹ 1,10,000

Calculate Manager Commission if commission rate is

a) 10% of net profit before charging manager's commission
b) 10% of net profit after charging manager's commission

INTEREST ON PARTNERS' CAPITAL

Type of Capital	Computation of Interest on Capital (IOC)
1. Opening Capital	IOC= Opening Capital x Rate of Interest
2. Additional Capital	IOC= Additional Capital x Rate of Interest x Period of use

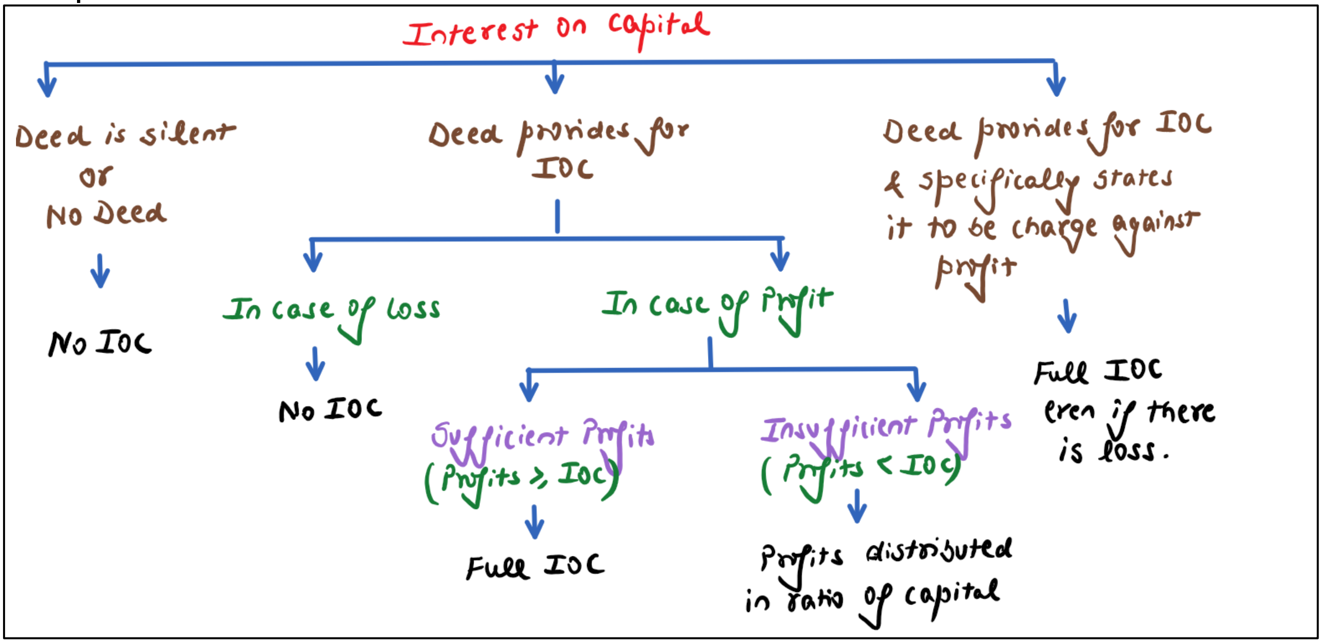
Example:

Ramesh & Naresh are partners in a firm. Their Capitals as on 1st April of a financial year were ₹ 3,00,000 and ₹ 1,20,000 respectively. They share profits equally. On 1st July, they decided that their Capitals should be ₹ 2,00,000 each. The necessary adjustment in the capitals was made by introducing or withdrawing cash. Interest on Capital is allowed at 8% p.a.

Compute the interest on capital for both Partners for the year ending 31st March.

Interest on Capital in case of Insufficient Profits or Loss

It is an appropriation. It will be paid to the partners if provided for in the agreement but only from profits. The treatment in different situations is as under-



Example:

X and Y are Partners sharing profits and losses in the ratio of 2:3 with a capital of ₹ 2,00,000 and ₹ 1,00,000 respectively. Show the distribution of profits/losses for the year ended 31st March, in each of the following cases-

Case 1: If Partnership Deed is silent as to IOC and profits for the year is ₹ 20,000.
Case 2: If Partnership Deed provides for IOC at 6% p.a. and loss for the year is ₹ 15,000.
Case 3: If Partnership Deed provides for IOC at 6% p.a. and profits for year is ₹ 21,000.
Case 4: If Partnership Deed provides for IOC at 6% p.a. and profits for year is ₹ 15,000.

Effective Capital

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 ₹ 1,00,000 & ₹ 80,000 respectively on 1st January 2023. The profits were to be shared in the Capital /Effective Capital ratio. Calculate effective capital, profit sharing ratio & Interest on capital @ 6% p.a.

Date	Capital Introduced		Capital Withdrawn	
	A	B	A	B
1st April	2,00,000			
1st July		40,000	1,00,000	

INTEREST ON PARTNERS' DRAWINGS

- ❖ Drawings refers to amount withdrawn by Partners, in cash or kind, for their personal use.
- ❖ Partners are supposed to pay interest on drawings only when provided by the agreement or agreed by the partners.
- ❖ Interest on drawings is gain for the business. It is recorded on credit side of P&L Appropriation A/c.
- ❖ Partner's Drawings A/c & interest on drawings is closed by transferring to debit side of Capital or Current A/c.

Interest on Drawings

- **Dates of Drawings not given**
  - P.a. → $IOD = Drawings \times \frac{Rate}{100} \times \frac{6}{12}$
  - ~~P.A.~~ → $IOD = Drawings \times \frac{Rate}{100}$
- **Dates of Drawings given**
  - Amount of each drawing same **and** Time interval b/w 2 drawings same
    - Direct Method
    - Product Method
    - Shortcut Method (Preferable)
  - Either amount not same **or** Time interval not same
    - Direct Method
    - Product Method (Preferable)
    - Shortcut Method (X)

Short Cut Method

$$IOD = \text{Total Drawings} \times \frac{Rate}{100} \times \frac{\text{Average Time Period}^{*}}{12}$$

TTP = Total Time Period

TI = Time Interval

* Average Time Period

	Beginning	Middle	End
	$\frac{TTP+TI}{2}$	$\frac{TTP}{2}$	$\frac{TTP-TI}{2}$
A) 12 Months Period			
a) Monthly	$\frac{12+1}{2} = 6.5$	$\frac{12}{2} = 6$	$\frac{12-1}{2} = 5.5$
b) Quarterly	$\frac{12+3}{2} = 7.5$	$\frac{12}{2} = 6$	$\frac{12-3}{2} = 4.5$
A) 6 Months Period			
a) Monthly	$\frac{6+1}{2} = 3.5$	$\frac{6}{2} = 3$	$\frac{6-1}{2} = 2.5$
b) Quarterly	$\frac{6+3}{2} = 4.5$	$\frac{6}{2} = 3$	$\frac{6-3}{2} = 1.5$

Example:

Compute interest on partners' Drawings in the following situations, if interest rate is 6% p.a. (Financial year of the firm ends on 31st December)

Date of withdrawal	Feb 1	May 1	June 30	Oct 31st
Amt. withdrawn (₹)	20,000	50,000	40,000	60,000

Example:

Compute interest on partners' Drawings in the following situations, if interest rate is 10% p.a.-

- ₹ 10,000 withdrawn per month, throughout the year, at – (a) beginning of each month, (b) middle of each month, and (c) end of each month.
- Drawings during the entire year ₹ 2,50,000 (details of withdrawal not available)
- Drawings during the entire year ₹ 2,50,000, & interest is to be calculated without reference to time factor (i.e., interest on drawing at 10% and not 10% p.a.)

PAST ADJUSTMENTS IN CAPITAL ACCOUNTS OF PARTNERS

Sometimes few errors & omissions in recording of transactions or the preparation of financial statements are found after final accounts have been prepared & profits distributed among partners. These omissions and errors may be in respect of:

- Interest on capitals,
- Interest on drawings,
- Partner's salary, partner's commission or
- There may also be some changes in the provisions of partnership deed or system of accounting having impact with retrospective effect.

All these acts of omission and commission need adjustments for correction.

Now instead of altering all the old accounts, necessary adjustments can be made either;

- ❖ Through Profit and Loss Adjustment Account, or
- ❖ Directly in the Capital Accounts of the concerned partners.

<u>Journal entry for adjustment is:</u>

Gaining partner capital/current A/c Dr.

To Sacrificing Partner capital/current A/c

TABLE

	A	B	Total
Items to be Recorded			
IOC	✓	✓	✓
Salary, Commission, etc.	✓	✓	✓
Share of Profit	✓	✓	✓
IOD	(✓)	(✓)	(✓)
CR.	✓	✓	✓
Items to be Reversed			
IOC	✓	✓	✓
Salary, Commission, etc.	✓	✓	✓
Share of Profit	✓	✓	✓
IOD	(✓)	(✓)	(✓)
DR.	✓	✓	✓
Difference	✓	✓	

Example:

A, B and C 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.

Case 1: For the year 2023 interest on capital @ 10% was not provided.

Case 2: For the year 2023 interest on capital was credited to them @ 12% instead of 10%.

Pass entry to rectify the error.

GUARANTEE OF MINIMUM PROFIT TO A PARTNER

1. Meaning: Sometimes, Partners may mutually agree that certain Partner (s) has the right to have minimum amount of profit. Such profit is called Guaranteed Profit or Guaranteed Minimum Profit.

Example: Guarantee given to a partner 'X' by the other partners 'Y & Z' means in case of loss or insufficient profits 'X' will withdraw the minimum guaranteed amount.

2. Treatment:

Situation	Steps in Computation/ Treatment
(a) If Profit Share > Guaranteed Profit	Distribute the Total Available Profit in the agreed profit sharing ratio, in the usual manner.
(b) If Profit Share < Guaranteed Profit	• Distribute the Total Available Profit in the agreed profit sharing ratio, in the usual manner. • Compute the shortfall in Guaranteed Profit, and add that to the share of the Partner entitled to the same. • Deduct the shortfall from the Profit shares of the Other Partners, as described below

Burden of Shortfall:

Guarantee given by	Shortfall to be reduced from
(a) One of the remaining partners	That Remaining Partner's Share of Profit
(b) Remaining 2 or all Partners in agreed ratio	Two or all Partners, in agreed ratio
(c) Remaining Partners in their mutual PSR	All remaining Partners in mutual PSR

Note: If the question is silent about nature of guarantee, situation (c) given above is assumed

Example

A, B & C partners with PSR 5:3:2. Guarantee given to Partner C of amount 50,000.
Guarantee given by:

1) A and Profits for the year 3,00,000
2) A and Profits for the year 2,00,000
3) A & B (Deficiency to be shared in mutual PSR) and Profits for the year 2,00,000
4) A & B (Deficiency to be shared in 3:2) and Profits for the year 2,00,000

LIMITED LIABILITY PARTNERSHIPS (LLP Act, 2008)

DEFINITIONS

LLP	a partnership formed and registered under this Act
LLP agreement	any written agreement between the partners of the LLP or between the LLP and its partners which determines the mutual rights & duties of the partners and their rights and duties in relation to that limited liability partnership.
Small LLP	Means a limited liability partnership— • the contribution of which, does not exceed 25 lakh rupees or such higher amount, not exceeding 5 crore rupees, as may be prescribed; and • the turnover of which, as per Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed 40 lakh rupees or such higher amount, not exceeding 50 crore rupees, as may be prescribed

NATURE OF LIMITED LIABILITY PARTNERSHIP

1) A LLP is a body corporate formed and incorporated under this Act and is a legal entity separate from that of its partners.
2) A LLP shall have perpetual succession.
3) Any change in the partners of LLP shall not affect the existence, rights or liabilities of LLP

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 LLP.

MINIMUM NUMBER OF PARTNERS

Any individual or body corporate may be a partner in a LLP.
Provided that an individual shall not be capable of becoming a partner of a LLP, 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 LLP shall have at least two partners.
If at any time the number of partners of a LLP is reduced below two and the LLP carries on business for more than six months while the number is so reduced, the person, who is the only partner of the LLP 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 LLP incurred during that period

DESIGNATED PARTNERS

Section 7

Every LLP shall have at least two designated partners who are individuals and at least one of them shall be a resident in India.

Provided that in case of a LLP in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as designated partners.

Explanation- For the purposes of this section, the term "*resident in India*" means a person who has stayed in India for a period of not less 120 days during the immediately preceding one year.

Subject to the provisions of sub-section (1),
1) if the incorporation document-
   a) specifies who are to be designated partners, such persons shall be designated partners on incorporation; or
   b) states that each of the partners from time to time of LLP is to be designated partner, every such partner shall be a designated partner;
2) any partner may become a designated partner by and in accordance with the LLP agreement and a partner may cease to be a designated partner in accordance with LLP agreement.
3) An individual shall not become a designated partner in any LLP unless he has given his prior consent to act as such to the LLP in such form and manner as may be prescribed.
4) Every LLP shall file with the registrar the particulars of every individual who has given his consent to act as designated partner in such form and manner as may be prescribed within thirty days of his appointment.
5) An individual eligible to be a designated partner shall satisfy such conditions and requirements as may be prescribed

LIABILITIES OF DESIGNATED PARTNERS

Unless expressly provided otherwise in this Act, a designated partner shall be-
a) responsible for the doing of all acts, matters and things as are required to be done by the limited liability partnership in respect of compliance of the provisions of this Act including filing of any document, return, statement and the like report pursuant to the provisions of this Act and as may be specified in the LLP agreement; and .
b) liable to all penalties imposed on the LLP for any contravention of those provisions.

LIMITATION OF LIABILITY OF AN LLP AND ITS PARTNERS

An obligation of an LLP arising out of a contract or otherwise, shall be solely the obligation of the LLP. The Liabilities of LLP shall be met out of the properties of the LLP
A partner is not personally liable, directly or indirectly, for an obligation referred to above, solely by reason of being a partner in the LLP
An LLP is not bound by anything done by a partner in dealing with a person, if: ❖ The partner does not have authority to act on behalf of LLP in doing a particular act & ❖ The other person knows that the partner has no authority or does not know or believe him to be a partner in the LLP
The liability of the LLP and the partners perpetrating fraudulent dealings shall be unlimited for all or any of the debts or other liabilities of the LLP
LLP is liable if a partner of LLP is liable to any person as a result of wrongful acts or omission on his part in the course of business of the LLP or with his authority

FINANCIAL DISCLOSURES AND RETURNS

Every LLP shall maintain such proper books of accounts as may be prescribed relating to its affairs for each year of its existence on cash basis or accrual basis and according to the double entry system of accounting and shall maintain the same at its registered office for such period as may be prescribed.
Every LLP shall within six months of the end of each financial year prepare a Statement of Account and Solvency for the said financial year as at the last day of the said financial year, in such form as may be prescribed, and such statement shall be signed by the designated partners of the LLP.
Every LLP shall file within the prescribed time, the Statement of Account and Solvency with the Registrar every year in such form and manner and accompanied by such fee as may be prescribed.
The accounts of an LLP must be audited in accordance with rules as prescribed. Provided that the Central Government may, by notification in the Official Gazette, exempt any class or classes of limited liability partnerships from the requirements of this sub-section

ASSIGNMENT QUESTIONS

Question 1 *(RTP May 2022)* *Pg no._____*

A and B are partners in a firm sharing profits and losses equally. On 1st April, 2020 the balance of their Capital Accounts were : A ₹ 50,000 and B ₹ 40,000. On that date the balances of their Current Accounts were: A ₹ 10,000 (credit) and B ₹ 3,000 (debit). Interest @ 5% p.a. is to be allowed on the balance of Capital Accounts as on 1.4.2020. B is to get annual salary of ₹ 3,000 which had not been withdrawn. Drawings of A and B during the year were ₹ 1,000 and ₹ 2,000 respectively.

The profit for year ended 31st March, 2021 before charging interest on capital but after charging B's salary was ₹ 70,000. It is decided to transfer 10% of divisible profit to a Reserve Account. Prepare Profit & Loss Appropriation Account for the year ended 31st March, 2021 and show Capital and Current Accounts of the Partners for the year.

Question 2 *(RTP May 2023)* *Pg no._____*

P, Q and R were partners in a firm sharing profits in the ratio of 1:2:2. After division of the profits for the year ended 31.03.2022 their capitals were: P ₹ 1,50,000. Q ₹ 1,80,000 and R ₹ 2,10,000. During the year they withdraw ₹ 20,000 each. The profit of the year was ₹ 60,000. The partnership deed provided that interest on capital will be allowed @ 10% p.a. While preparing the final accounts, interest on partners' capital was not allowed. You are required to pass the necessary adjustment entity for providing interest on capital.

Question 3 *(CA Foundation Dec 2021) (5 Marks)* *Pg no._____*

A, B and C are partners in a firm. On 1st April 2019 their fixed capital stood at ₹ 50,000, ₹ 25,000 and ₹ 25,000 respectively.

As per the provision of partnership deed:

(1) C was entitled for a salary of 5,000 p.a.
(2) All the partners were entitled to interest on capital at 5% p.a.
(3) Profits and losses were to be shared in the ratio of Capitals of the partners.

Net Profit for the year ended 31st March, 2020 of ₹ 33,000 and 31st March,2021 of ₹ 45,000 was divided equally without providing for the above adjustments.

You are required to pass an adjustment journal entry to rectify the above errors.

Question 4 *Pg no._____*

A and B formed a partnership with a capital contribution of ₹ 50,000 and ₹30,000 respectively on 1st January 2023. 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	B	A	B
31 March	5,000	-	-	2,000
1 July	-	9,000	3,000	-
1 September	5,500	-	-	1,000
1 November	-	4,000	4,500	-

Question 5 *(ICAI Study Material)* *Pg no._____*

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 (1.1.2023)	75,000	40,000	30,000
Current Account (1.1.2023)	10,000	5,000	5,000 (Dr.)
Drawings	15,000	10,000	10,000

The draft accounts for 2023 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, 2023 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, 2023 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, 2023.

Question 6 *(ICAI Study Material)* *Pg no._____*

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, 2023, 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, 2023 is ₹ 1,10,000. Show the distribution of net profit amongst the partners

Question 7 *(RTP May 2021)* *Pg no._____*

Rose, Lilly and Lotus start business with capital of ₹ 2,00,000/-, ₹ 3,00,000/- and ₹4,00,000 on 1st April 2019. Lotus is entitled to a salary of ₹ 50,000 per annum. Interest is allowed on capitals at 12% p.a. and is charged on drawings at 12% per annum. Profits are to be distributed in the ratio 1:2:3 after the above-mentioned adjustments. Rose was given guarantee of minimum profit of ₹ 50,000 by Lotus. Partners drawings during the year were Rose ₹ 40,000/- Lilly ₹ 30,000/- Lotus ₹ 20,000/-.

Lotus had paid ₹ 10,000/- as tuition fees of his son on 31st March 2020, which was wrongly debited to salaries account. The profit for the year 2019-20 before allowing interest on capital and charging interest on drawings and salary paid to Lotus was ₹3,34,600/-.

Assuming the capitals to be fixed, prepare the Profit and Loss Appropriation Account and the Capital and Current Accounts relating to the partners.

PRACTICE QUESTIONS

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

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.

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.

4) In the absence of an agreement, partners are entitled to
   (a) Interest on Loan and Advances.
   (b) Commission.
   (c) Salary.

5) Partners are supposed to pay interest on drawings only when .... by the ....
   (a) Provided, Agreement.
   (b) Agreed, Partners
   (c) Both (a) & (b) above.

6) 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

7) 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.

8) 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.

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 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.

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 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.

ANSWERS MCQs
1 (c) 2 (c) 3 (a) 4 (a) 5 (c) 6 (a) 7 (a) 8 (a) 9 (c) 10 (c)

TRUE / FALSE

State with reasons, whether the following statements are true or false:
1) In absence of any agreement partners share profits of the business in the ratio of their capital contribution.
2) Profit sharing ratio and capital contribution ratio need not be same.
3) Every partnership firm must register itself with Registrar of firms.
4) A partner can advance loan to the partnership firm in addition to capital contributed by him.
5) A partner can demand interest on capital even if it is not 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.
7) Interest should be paid @ 6% p.a. on partners' loan even if it is not provided in the partnership deed.
8) Husband and wife can not be partners in the same firm.
9) One senior partner is Principal and other partners are his agents.
10) Partners are the agents of the firm and each other.
11) A partner who devotes more time to a business than other partners is entitled to get a salary.
12) Partners can share profits or losses in their capital ratio, when there is no agreement
13) The business of partnership firm must be carried on by all the partners.
14) When there is no partnership deed prevails, the interest on loan of a partner to be paid @ 6%. *(May 2018)*
15) Limited Liability Partnership (LLP) is governed by Indian Partnership Act, 1932. *(May 2019)*
16) A Partnership firm cannot own any Assets. *(Nov 2019)*
17) A partnership firm can acquire fixed assets in the name of the firm.

Solution

1) False: In absence of any agreement partners share profits equally and not in capital contribution ratio.
2) 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) False: Registration of firms is not compulsory under Indian Partnership Act 1932.
4) True: Yes loan can given to the firm by the partner in addition to the capital. Where the partnership deed is absent, then the interest shall be paid at a minimum of 6% per annum. So the interest on the loan to be paid to the partner.
5) False: Interest on capital can be paid only if it is provided in the partnership deed.
6) 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) True: Yes as per the provisions of the law- it is necessary that the interest on loan at 6% per annum shall be paid to the concerned partner.
8) False: Husband and wife can be partners in the same firm.
9) False: There is no senior or junior partner. Every partner is agent/principal of other partners.
10) 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) False: Unless and until the partnership deed specifically provides for the entitlement of salary, no partner can receive it.
12) False: According to the Partnership Act, 1932, when there is no agreement the partners are to share the profit and loss equally among themselves.
13) False: According to the Partnership Act, 1932, partnership can be carried on by all or any of them acting for all.
14) True: When there is no partnership deed then the provisions of the Indian Partnership Act are to be applied for settling the dispute. Interest on loan is payable @ 6% p.a. as per Indian Partnership Act
15) False: The provisions of the Indian Partnership Act, 1932 shall not apply to a limited liability partnership. Limited Liability (LLPs) Act, 2008 is applicable for Limited Liability Partnerships.
16) True: A partnership firm is not a distinct legal entity and therefore can't own any assets. The partners own the assets of the firm
17) False: A partnership firm cannot acquire fixed assets in its name since it is not a separate legal entity. It acquires fixed assets in the name of its partners.

HOMEWORK QUESTIONS

Question 1 *(ICAI Study Material)* *Pg no._____*

Ram and Rahim started business with capital of ₹ 50,000 and ₹ 30,000 on 1st January, 2023. 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 Fixed capitals, Prepare Profit & Loss Appropriation Account and Capital & Current Accounts of the partners

Question 2 *(ICAI Study Material)* *Pg no._____*

A and B started business on 1st January, 2023, 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 capitals at 6% per annum. The remaining profits are to be distributed amongst partners in the ratio of 5:3. During 2023 firm earned profit, before charging salary to B & interest on capital amounting ₹ 25,000. During year A & B withdrew ₹ 8,000 & ₹ 10,000 for domestic purposes. Pass Journal entries relating to division of Profit and Prepare P&L Appropriation A/c & Capital Accounts.

Question 3 *Pg no._____*

On 1st April, 2020, X, Y and Z enter into partnership introducing capital of ₹80,000, ₹50,000 and ₹50,000 respectively. They agree to share Profits and Losses equally. At the end of the accounting year on 31st March, 2021, X claims that he be paid interest on his additional Capital of ₹30,000 @ 10% per annum, while Z demands salary of ₹600 per month for the extra hours devoted by him daily at the shop. The partnership deed is silent on these matters. Decide the matters with reasons.

Question 4 *(ICAI Study Material)* *Pg no._____*

Ram, Rahim and Karim 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:

a) Ram, 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.
b) Rahim 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.
c) Karim demands interest on loan of ₹ 2,000 advanced by him at 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.

Question 5 *(ICAI Study Material)* *Pg no._____*

X and Y are partners. As per terms of agreement interest is allowed on capital at 8% p.a. and charge on drawing 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, 2023

Particulars	Amount	Particulars	Amount
To ...?	?	By Profit and Loss A/c (Net profit)	?
To Interest on Capital A/c X 160,000 Y ?	2,88,000	By Interest on Drawings A/c X ? Y ?	?
To Profit tfd 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	Nil
To ....?	?	?	By ....?	?	?
			By ....?	?	?
	?	?		?	?

Question 6 *(RTP May 2018) / (May 2020) / (Nov 2021) / (Nov 2022) (Similar)* *Pg no._____*

A, B and C entered into partnership on 1.1.2021 to share profits and losses in the ratio of 5 : 3 : 2. A personally guaranteed that C's share of profit after charging interest on capitals at 5% p.a. would not be less than ₹ 30,000 in any year. Capitals of A, B and C were ₹ 3,20,000, ₹ 2,00,000 and ₹ 1,60,000 respectively. Profits for the year ending 31.12.2021 before providing for interest on partners capital was ₹ 1,59,000. You are required to prepare the Profit and Loss Appropriation Account

Question 7 *(ICAI Study Material)* *Pg no._____*

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, 2023 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.

Question 8 *(ICAI Study Material)* *Pg no._____*

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, 2023. A introduced a further capital of ₹ 10,000 on 1st April, 2023 and another ₹ 5,000 on 1st July, 2023. On 30th September, 2023 A withdrew ₹ 40,000.
On 1st July, 2023, 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, 2023. B drew ₹ 1,000 on 30th June, and ₹ 5,000 on 30th September, 2023.
12% p.a. interest on capital is allowable and 10% p.a. interest on drawings is chargeable. Date of closing 31.12.2023.
Calculate: (a) Profit-sharing ratio; (b) Interest on capital; and (c) Interest on drawings.

Question 9 *(CA Foundation Jan 2021) (5 Marks)* *Pg no._____*

Discuss the rules if there is no Partnership Agreement.

Question 10 *(CA Foundation June 2023) (5 Marks)* *Pg no._____*

X and Y were partners in a firm, sharing profit and losses in the ratio of 3: 2. They admit Z for 1/6th share in profits and guaranteed that his share of profits will not be less than 50,00,000. Total profits of the firm for the year ended 31st March, 2022 were 1,80,00,000. Calculate share of profit for each partner when:

(i) Guarantee is given by firm

(ii) Guarantee is given by X and Y equally.