CHAPTER 2

Accounting for Partnership Firms—Fundamentals

LEARNING OBJECTIVES

The study of this Chapter would enable you to understand:

MEANING AND DEFINITION OF PARTNERSHIP

Partnership is defined by Indian Partnership Act, 1932, Section 4, as follows:

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

A partnership, thus, is a business relationship among two or more persons to share profits and losses of the business, carried on by all or any of them acting for all.

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

Nature of Partnership

Partnership, from the legal viewpoint, is not a separate legal entity from its partners. It means, firm's debts can be paid from private assets of the partners, if the firm is not able to pay its liabilities.

Partnership is a separate business entity from the accounting viewpoint.

ESSENTIAL FEATURES OR CHARACTERISTICS OF PARTNERSHIP

The essential characteristics of partnership are:

1. **Two or More Persons:** There must be at least two persons to form a partnership and all such persons must be competent to contract. According to Indian Contract Act, 1872, every person except the following are competent to contract:
   (a) Minor,
   (b) Persons of unsound mind, and
   (c) Persons disqualified by any law.

   Maximum Number of Partners: The Companies Act, 2013 (Section 464) empowers the Central Government to prescribe number of partners in a firm subject to maximum of 100 partners. The Central Government has prescribed maximum number of partners in a firm to be 50 vide Rule 10 of the Companies (Miscellaneous) Rules, 2014. Thus, in effect, a partnership firm cannot have more than 50 partners.
2. **Agreement:** Partnership comes into existence by an agreement, either written or oral. It is the basis of relationship among partners, which may be for a particular venture, for a period or at will. The written agreement among the partners is known as **Partnership Deed**.
3. **Lawful Business:** A partnership is established for a lawful business.
4. **Profit-sharing:** The agreement between/among the partners must be to share profits and losses of the business. It is not essential that all the partners must share losses.
5. **Business can be carried on by All or Any of the Partners Acting for All:** Business of the partnership can be carried on by all the partners or by any of them acting for all the partners. In other words, partners are agents as well as the principals.

   As an *agent*, he represents other partners and thereby, binds them through his acts.

   As a *principal*, he is bound by the act of other partners.

RIGHTS OF PARTNERS

1. Every partner has the right to participate in the management of the business.
2. Every partner has the right to be consulted about the affairs of the business.
3. Every partner has the right to inspect the books of account and have a copy of it.
4. Every partner has the right to share profits or losses with others in the agreed ratio.
5. If a partner has advanced loan, he has the right to receive interest thereon at an agreed rate of interest. In case the rate of interest is not agreed, interest is paid at the rate provided in the Indian Partnership Act, 1932, *i.e.*, @ 6% p.a.
6. In case of an emergency, a partner has the right to act according to his best judgment and be indemnified for the expenses incurred by him.
7. A partner has the right not to allow the admission of a new partner.
8. After giving proper notice, a partner has the right to retire from the firm.
9. If a partner incurs expenses on the business or he pays amount on behalf of the firm, that partner gets indemnified for the payments made by him from the firm.

PARTNERSHIP DEED

Partnership comes into existence by an oral or written agreement. It is better to have written agreement to avoid any dispute. This written document known as **Partnership Deed** details the terms and conditions of partnership. It is a legal document signed by all the partners and has clauses on the following:

(i) ***Description of the Partners:*** Names, description and addresses of the partners.

(ii) ***Description of the Firm:*** Name and address of the firm.

(iii) ***Principal Place of Business:*** Address of the principal place of business.

(iv) ***Nature of Business:*** Nature of business that the firm shall carry on.

(v) ***Commencement of Partnership:*** Date of commencement of partnership.

(vi) ***Capital Contribution:*** The amount of capital to be contributed by each partner, whether the Capital Accounts shall be fixed or fluctuating.

(vii) ***Interest on Capital:*** Rate of interest, if allowed, on capital.

(viii) ***Interest on Drawings:*** Rate of interest, if to be charged, on drawings.

(ix) ***Profit-sharing Ratio:*** Ratio in which profits or losses are to be shared by the partners.

(x) ***Interest on Loan:*** Rate of interest on loan by a partner to the firm.

(xi) ***Remuneration to Partners:*** Amount of salary, commission, etc., if agreed, to be paid.

(xii) ***Valuation of Goodwill:*** Method by which goodwill of the firm will be valued at the time of admission or retirement of a partner or at the time of death of a partner.

(xiii) ***Valuation of Assets:*** The manner in which assets of the firm shall be valued in the case of its reconstitution.

(xiv) ***Settlement of Account:*** The manner in which accounts of partner(s) shall be settled in case of his (their) retirement or death or at the time of dissolution of the firm.

(xv) ***Accounting Period:*** The date on which accounts shall be closed every year. Normally accounts are closed on 31st March every year because every entity must submit the return of income on 31st March every year.

(xvi) ***Rights and Duties of Partners:*** The rights and duties of partners are defined.

(xvii) ***Duration of Partnership:*** The period of partnership, *i.e.*, whether it is for a specified period or for a venture or at will.

(xviii) ***Bank Account Operation:*** How shall the Bank Account be operated? Whether it shall be operated by any of the partners or jointly.

(xix) ***Death of a Partner:*** Whether the firm will continue or dissolve.

(xx) ***Settlement of Disputes:*** Disputes, if any, among the partners—how they shall be settled.

Importance of Partnership Deed

Partnership Deed is an important legal document which defines relationship among the partners. It is important to have written Partnership Deed to avoid and settle possible disputes. It is useful because:

1. It governs the rights, duties and liabilities of each partner.
2. Disputes arising, if any, among the partners are settled on the basis of Partnership Deed, it being a written contract.

Is it essential to have a Partnership Deed?

It is not essential but desirable to have a Partnership Deed. In case Partnership Deed does not exist, provisions of the Indian Partnership, Act, 1932 will apply.

Provisions Affecting Accounting Treatment in the Absence of Partnership Deed

In the absence of a Partnership Deed or where it is silent, *i.e.*, it does not have a clause in respect of the following matters, the provisions of the Indian Partnership Act, 1932 apply:

Matters	*Provisions of the Indian Partnership Act, 1932*
1. **Sharing of Profits/Losses**	Profits/Losses are shared *equally* by the partners.
2. **Interest on Capital**	Interest on capital is *not paid* (*allowed*) to partners.
3. **Interest on Drawings**	Interest on drawings is *not charged* from partners.
4. **Interest on Advance/Loan by a Partner**	Interest on loan by partner is *paid* (*allowed*) *@ 6% p.a.* *Interest on loan by partner is a charge against profit. It means interest is paid whether the firm earns profit or incurs loss.*
5. **Remuneration to Partners**	Remuneration (salary, commission, etc.,) is *not paid (allowed)* to any partner.
6. **Admission of Partner**	New partner cannot be admitted unless all the partners agree to it.

The partners may amend the Partnership Deed to include or change any of the above clauses.

Liabilities of Partners

Subject to agreement among the partners,

1. If a partner carries on a business that is similar to that of the firm in competition with the firm and earns profit from it, the profit earned from such business shall be paid to the firm.
2. If a partner earns profit for himself from any transaction of the firm or from the use of firm's property or business connection, the profit so earned shall be paid to the firm. For example, a partner gets commission from the buyer of goods on goods sold by the firm, the commission so earned shall be paid to the firm.

Some other Important Provisions of the Indian Partnership Act, 1932

(i) If all the partners agree, a minor may be admitted for the benefit of partnership. [Sec. 30]

(ii) A person may be admitted as a partner *either* with the consent of all the existing partners *or* in accordance with an agreement among the partners. [Sec. 31]

(iii) A partner may retire from the firm *either* with the consent of all the other partners *or* in accordance with an agreement among the partners. [Sec. 32]

(iv) Registration of the firm is optional and not compulsory. [Sec. 69]

(v) Unless otherwise agreed by the partners in the Partnership Deed, a firm is dissolved on the death of a partner. [Sec. 35]

Note: It should be noted that above provisions of the Indian Partnership Act, 1932 are applied when Partnership Deed does not exist or where it exists but it does not have a clause to this effect.

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

Ambrish, Lalit and Charu are partners in a firm without a Partnership Deed.

(i) Ambrish, has contributed more capital than other partners and demands interest on capital at 10% p.a. But Lalit and Charu do not agree with him.

(ii) Lalit devotes full time in the business and demands a salary of ₹ 5,000 p.m. But Ambrish and Charu do not agree with him.

(iii) Charu demands interest on the loan of ₹ 50,000 given by her at the market rate of interest, *i.e.*, @ 12% p.a.

(iv) Ambrish has withdrawn ₹ 10,000 from the firm for his personal use. Lalit and Charu demand that interest on drawings should be charged @ 10% per annum.

(v) Profit before taking into account any of the above claims was ₹ 50,000 at the end of the first year of the business. Ambrish demands share of profit in the capital ratio.

(vi) Lalit wants to introduce his son Inder as partner. Charu objects to his proposal.

How will be the matters resolved?

Solution:

The partners do not have a Partnership Deed. Therefore, provisions of the Indian Partnership Act, 1932 will apply to resolve the matters:

(i) Interest on capital is not payable to partner. Therefore, Ambrish will not get interest on the capital.

(ii) Remuneration is not payable to partner. Therefore, Lalit will not get salary.

(iii) Interest on Loan by Partner is payable @ 6% p.a. Therefore, Charu will get interest ₹ 3,000 (*i.e.*, ₹ 50,000 × 6/100).

(iv) Interest on Ambrish's Drawings will not be charged.

(v) Profit after Interest on Loan by Charu, *i.e.*, ₹ 47,000 is to be distributed equally.

(vi) A person cannot be introduced as partner without the consent of all the partners. Therefore, Inder cannot be admitted into partnership because Charu objects to it.

Illustration 2 (*Oral Agreement*).

Harry and Garry are partners in a firm. They have not entered into Partnership Deed but had agreed on following:

(i) Salary will be paid to Harry @ ₹ 10,000 per month.

(ii) Garry will get commission @ 10% of Net Profit.

(iii) Interest will be allowed on capitals @ 10% p.a.

(iv) Interest will be charged on drawings @ 10% p.a.

(v) Partner cannot be admitted without the consent of both the partners.

How will be the following disputes resolved?

1. Garry demands to be paid salary as Harry is being paid because his commission is lower.
2. Harry demands that his son Sherry be admitted as partner for 25% share to be given out of his share of profits to which Garry disagrees.

Solution:

Partnership agreement may be written or oral. Therefore, the terms agreed orally between Harry and Garry is a valid agreement.

1. The demand of Garry to be paid salary as is paid to Harry is not valid in view of agreement of payment of commission.
2. Harry's demand to admit Sherry into partnership is also not valid as both the partners had agreed to admit a new partner with the consent of both the partners.

Charge against Profit and Appropriation of Profit

Payment made or due to a partner may be a charge against profit or an appropriation of profit.

Charge against Profit means that it is an expense for the firm and is paid whether the firm earns profit or incurs loss. On the other hand, appropriation of profit means that they are allowed, if the firm earns profit during the year.

Interest on Loan by Partner, Rent Payable to a partner and Manager's Commission, etc., are charge against profit and are payable whether the firm earns profit or incurs loss.

On the other hand, Salary/Commission to partners, interest on capitals and transfer of profit to Reserves are appropriations.

Difference between Charge Against Profit and Appropriation of Profit

Basis	*Charge Against Profit*	*Appropriation of Profit*
1. **Nature**	It is an expense hence deducted from revenue to determine net profit or loss for the year.	It means distribution of net profit for the year among partners under different heads as per the Partnership Deed.
2. **Recording**	It is debited to Profit and Loss Account.	It is debited to Profit and Loss Appropriation Account.
3. **Priority**	It is allowed before Appropriation of Profit.	It is appropriated after accounting of all charges.
4. **Examples**	Rent paid to a partner, interest on loan by partner, etc.	Salary to partners, interest on capital, transfer of profit to General Reserve, etc.

INTEREST ON LOAN BY THE PARTNER AND BY THE FIRM TO THE PARTNER

Interest on Loan by the Partner to the Firm

If any partner has given loan to the firm, he shall get interest at the agreed rate as written in the Partnership Deed or as agreed otherwise. In the absence of an agreement, the Indian Partnership Act, 1932 will apply and the lending partner will get *interest @ 6% p.a. on loan amount*.

Nature of Interest on Loan by Partner

Interest on loan by partner is a charge against profit. It means that a partner will get interest on loan whether the firm earns profit or incurs loss.

Accounting Treatment

Interest on loan by partner is credited to his Loan Account and not to his Capital Account. Journal entries passed are:

(i) *To provide Interest on Loan by Partner:*

Interest on Loan by Partner A/c ...Dr.
  To Loan by Partner A/c

(ii) *To close the Interest on Loan by Partner A/c:*

Profit and Loss A/c ...Dr.
  To Interest on Loan by Partner A/c

It is important to distinguish Loan Account and Capital Account of a partner because:

1. As per the Indian Partnership Act, 1932, loan by a partner is repayable on dissolution before repayment of capital to partners; and
2. In the absence of any agreement, partners get interest @ 6% p.a. on loan advanced whereas they are not entitled to interest on capital.

Illustration 3.

Amit, Bimal and Chaman are partners sharing profits and losses equally. Amit and Chaman gave loans to the firm on 1st October, 2019 of ₹ 1,00,000 and ₹ 1,50,000 respectively. It is agreed that interest @ 9% p.a. will be paid on loan. Books of account of the firm are closed on 31st March every year. Interest on loan is yet to be paid as on 31st March, 2020.

Pass Journal entries in the books of account of the firm and prepare Loan Accounts of the two partners.

Solution:

In the Books of Amit, Bimal and Chaman

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2019				
Oct. 1	Bank A/c ...Dr.		2,50,000	
	To Loan by Amit A/c			1,00,000
	To Loan by Chaman A/c			1,50,000
	(Loan from partners Amit and Chaman)			
2020				
March 31	Interest on Loan by Partners A/c ...Dr.		11,250	
	To Loan by Amit A/c			4,500
	To Loan by Chaman A/c			6,750
	(Interest on loan by partners provided @ 9% p.a.)			
March 31	Profit and Loss A/c ...Dr.		11,250	
	To Interest on Loan by Partners A/c			11,250
	(Interest on Loan by Partners Account transferred to Profit and Loss Account)			

Dr. LOAN BY AMIT ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020			2019		
March 31	To Balance *c/d*	1,04,500	Oct. 1	By Bank A/c	1,00,000
			2020		
			March 31	By Interest on Loan by Partners A/c	4,500
		1,04,500			1,04,500
			2020		
			April 1	By Balance *b/d*	1,04,500

Dr. LOAN BY CHAMAN ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020			2019		
March 31	To Balance *c/d*	1,56,750	Oct. 1	By Bank A/c	1,50,000
			2020		
			March 31	By Interest on Loan by Partners A/c	6,750
		1,56,750			1,56,750
			2020		
			April 1	By Balance *b/d*	1,56,750

Illustration 4.

Akhil and Bharat are partners sharing profits and losses in ratio of 2 : 3 with capitals of ₹ 2,00,000 and ₹ 1,00,000 respectively. On 1st October, 2019, Akhil and Bharat gave loans of ₹ 4,00,000 and ₹ 2,00,000 respectively to the firm. There is no agreement as to payment of interest on the loan by partner. Determine the amount of profit or loss for the year ended 31st March, 2020 in each of the following cases to be distributed between the partners:

Case 1. If the Profit before interest for the year amounted to ₹ 25,000.

Case 2. If the Profit before interest for the year amounted to ₹ 15,000.

Case 3. If the Loss before interest for the year amounted to ₹ 25,000.

Solution:

When there is no agreement for payment of interest on loan by partner, as per the Indian Partnership Act, 1932, interest @ 6% p.a. is allowed on loan by a partner.

Case 1. Distributable Profit/Loss = Profit before Interest – Interest on Loan by Partners

= ₹ 25,000 – ₹ 18,000* = ₹ 7,000.

*Interest on Loan by Akhil (₹ 4,00,000 × 6/100 × 6/12)	₹ 12,000
Interest on Loan by Bharat (₹ 2,00,000 × 6/100 × 6/12)	₹ 6,000
Total	₹ 18,000

Case 2. Distributable Profit/Loss = Profit before Interest – Interest on Loan by Partners

= ₹ 15,000 – ₹ 18,000 = ₹ 3,000 (Loss).

Interest on loan by partner being a charge against profit is paid or credited to Loan by Partners Account even if profit is less than the amount of interest on loan. The resulting loss is distributed between partners in the profit-sharing ratio.

Case 3. Distributable Profit/Loss = Loss before Interest + Interest on Loan by Partners

= ₹ 25,000 + ₹ 18,000 = ₹ 43,000 (Loss).

Interest on Loan by the Firm to Partner

A firm may give loan to a partner. It will charge interest on the loan given at the rate agreed among the partners. If the Partnership Deed does not provide for charging interest on loan given or agreement to charge interest does not exist, interest is *not* charged on the loan given.

If interest is charged on loan by the firm to a partner, interest is transferred to the credit of Profit and Loss Account and debit of Partner's Capital Account (if Capital Accounts are maintained following Fluctuating Capital Accounts Method) or Partner's Current Account (if Capital Accounts are maintained following Fixed Capital Accounts Method).

The Journal entries are:

(i) *For Charging Interest on Loan to Partner:*

Partner's Capital/Current A/c ...Dr.
  To Interest on Loan to Partner A/c (Given)

(ii) *For Transfer of Interest on Loan to Partner Account:*

Interest on Loan to Partner A/c ...Dr.
  To Profit and Loss A/c

Rent Paid or Payable to a Partner

Rent paid or payable to a partner, is also a charge against profit and not an appropriation of profit. It is a charge on profit because rent is payable to a partner for letting the firm use his personal property for business. Rent may be paid (either in cash or by cheque) during the year to the partner or it may have become due but is not yet paid, i.e., is still payable. When it is paid or payable, it is debited to Rent Account and credited to Cash/Bank Account or Rent Payable Account. At the end of the year. Rent Account is transferred or debited to Profit and Loss Account (not to the Profit and Loss Appropriation Account).

Journal entries in this case will be as follows:

(i) *When rent is paid in cash or by cheque:*

Rent A/c ...Dr.
  To Cash/Bank A/c
(Rent paid in cash/cheque for ...)

(ii) *When rent is payable:*

Rent A/c ...Dr.
  To Rent Payable A/c
(Rent payable for ...)

(iii) *When Rent Account is transferred to Profit and Loss Account:*

Profit and Loss A/c ...Dr.
  To Rent A/c
(Rent Account transferred to Profit and Loss Account)

Illustration 5 (*Rent paid and Rent Payable*).

Amrit and Bimal are partners sharing profits equally. Bimal has given his property on rent to the firm on 1st April, 2019 at a monthly rent of ₹ 5,000. The firm paid him rent from April, 2019 to February, 2020 by issuing a cheque on 1st March, 2020. Rent for the month of March was still payble.

Pass the Journal entries for the above transactions.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2020 March 1	Rent A/c	...Dr.		55,000	
	To Bank A/c				55,000
	(Cheque issued for rent for the months April, 2019 to February, 2020)				
	Rent A/c	...Dr.		5,000	
	To Rent Payable A/c				5,000
	(Rent payable for the month of March, 2020)				
2021 March 31	Profit and Loss A/c	...Dr.		60,000	
	To Rent A/c				60,000
	(Rent Account transferred to Profit and Loss Account)				

Manager's Commission

Manager is an employee of the firm. Therefore, the amount due to him as commission is payable whether the firm earns profit or incurs loss. Stating differently, Manager's Commission is a charge against profit and transferred to the debit of Profit and Loss Account.

DISTRIBUTION OF PROFIT AMONG PARTNERS: PROFIT AND LOSS APPROPRIATION ACCOUNT

A partnership firm, like a proprietorship firm, prepares Trading Account, Profit and Loss Account and Balance Sheet. In addition, a partnership firm prepares Profit and Loss Appropriation Account to which *net profit* or *net loss* as per the Profit and Loss Account is transferred to appropriate it as per the agreement among partners. This account, is an *extension of the Profit and Loss Account*, and is credited with the amount of Net Profit or debited with the amount of Net Loss (transferred from Profit and Loss Account). It is credited with the amount of interest on drawings of the partners (which is loss to the partners but an income for the firm) and debited with interest on the capitals of the partners, partners' salaries and commissions, etc., (which are losses for the firm and incomes for the partners).

If the partners decide, an amount is transferred to Reserve and the balance profit (Divisible Profit) is distributed between/among the partners in their profit-sharing ratio.

It should be noted that profit is appropriated up to the amount available for distribution, *i.e.*, Divisible Profit. Thus, if after transfer of net loss and credit of interest charged on drawings to Profit and Loss Appropriation Account, the balance is loss, appropriation is not made. The loss is distributed among the partners in their profit-sharing ratio. But if it results in profit, appropriation is made up to the amount of profit.

***Net Profit** is the profit earned by an enterprise from its operating and non-operating activities. It is the net effect of operating and non-operating revenues and expenses that are charge against profit. It is determined by preparing Profit and Loss Account.*

***Divisible or Distributable Profit** is the profit that is available for distribution among partners after allowing remuneration (Salary, Commission, etc.) to partners, interest on capitals, transfer to reserve and charging interest on drawings. It is determined by preparing Profit and loss Appropriation Account.*

Profit and Loss Appropriation Account is an extension of the Profit and Loss Account. Net profit or loss as per Profit and Loss Account is transferred to Profit and Loss Appropriation Account.

Following are considered as appropriation of profit and therefore are transferred (posted) to the debit of Profit and Loss Appropriation Account:

(i) Salary/Commission to Partners;
(ii) Interest on Capitals of Partners; and
(iii) Transfer to Reserves.

Interest on Drawings is transferred (posted) to the credit of Profit and Loss Appropriation Account.

Specimen of the Profit and Loss Appropriation Account

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended ...

Dr. | Cr.

Particulars		₹	Particulars		₹
To Profit and Loss A/c (Net Loss^{+} transferred from Profit and Loss Account)		...	By Profit and Loss A/c (Net Profit^{+} transferred from Profit and Loss Account)		...
To Interest on Capitals:			By Interest on Drawings:		
Abhay	...		Abhay	...	
Bhaskar	...	...	Bhaskar	...	...
To Partners' Salaries		...	By Loss^{+} transferred to:		
To Partners' Commissions		...	*Abhay's Capital A/c	...	
To Reserve		...	**(or Abhay's Current A/c)		
To Profit^{+} transferred to:			*Bhaskar's Capital A/c	...	...
*Abhay's Capital A/c	...		**(or Bhaskar's Current A/c)		
**(or Abhay's Current A/c)					
*Bhaskar's Capital A/c	...	...			
**(or Bhaskar's Current A/c)					
		...			...

$^{+}$Either of the two will exist.

*Under Fluctuating Capital Accounts Method

**Under Fixed Capital Accounts Method

Always remember that amount payable to a partner (except interest on loan and rent) such as interest on capital (if not specified to be a charge), salary, commission, etc., are appropriation of profit.

JOURNAL ENTRIES RELATING TO THE PROFIT AND LOSS APPROPRIATION ACCOUNT

1. **Transfer of profit from Profit and Loss Account to Profit and Loss Appropriation Account**	Profit and Loss A/c ...Dr. To Profit and Loss Appropriation A/c (Profit transferred)
2. **Transfer of loss from Profit and Loss Account to Profit and Loss Appropriation Account**	Profit and Loss Appropriation A/c ...Dr. To Profit and Loss A/c (Loss transferred)
3. **For Partners' Salaries/Commission**	(i) Partners' Salaries/Commission A/c ...Dr. To Partners' Capital/Current** A/cs (Individually) (Salaries/commission allowed to partners)
	(ii) *To Close Salaries/Commission Account* Profit and Loss Appropriation A/c ...Dr. To Partners' Salaries/Commissions A/cs (Salaries/commission allowed to partners transferred to Profit and Loss Appropriation Account)
	Alternatively, a combined entry may be passed as: Profit and Loss Appropriation A/c ...Dr. To Partners' Capital/Current** A/cs (Individually) (Salaries/commission allowed to partners transferred to Profit and Loss Appropriation Account)
4. **For Allowing Interest on Capitals**	(i) Interest on Capital A/c ...Dr. To Partners' Capital/Current** A/cs (Individually) (Interest on capitals allowed to partners @ ....% p.a.)
	(ii) *To Close Interest on Capital Account* Profit and Loss Appropriation A/c ...Dr. To Interest on Capital A/c (Interest on capital allowed transferred to Profit and Loss Appropriation Account)
	Alternatively, a combined entry may be passed as: Profit and Loss Appropriation A/c ...Dr. To Partners' Capital/Current** A/cs (Individually) (Interest on capitals transferred to Profit and Loss Appropriation Account)
5. **For Charging Interest on Drawings**	(i) Partners' Capital/Current** A/cs (Individually) ...Dr. To Interest on Drawings A/c (Interest charged on drawings)
	(ii) *To Close Interest on Drawings Account* Interest on Drawings A/c ...Dr. To Profit and Loss Appropriation A/c (Interest charged on drawings transferred to Profit and Loss Appropriation Account)
	Alternatively, a combined entry may be passed as: Partners' Capital/Current** A/cs (Individually) ...Dr. To Profit and Loss Appropriation A/c (Interest charged on drawings and transferred to Profit and Loss Appropriation Account)

6. **For Transfer to Reserve out of Profit***	Profit and Loss Appropriation A/c To Reserve A/c (Amount transferred to Reserve)	...Dr.
7. **For Transfer of Credit Balance of Profit and Loss Appropriation Account (being Divisible/Distributable Profit)**	Profit and Loss Appropriation A/c To Partners' Capital/Current** A/cs (Individually) (Balance profit transferred to Capital/Current** Accounts of partners in their profit-sharing ratio)	...Dr.
8. **For Transfer of Debit Balance of Profit and Loss Appropriation Account (Loss)**	Partners' Capital/Current** A/c To Profit and Loss Appropriation A/c (Loss transferred to Capital/Current** Accounts of partners in their profit-sharing)	...Dr.

*Reserve is an amount set aside out of profit to strengthen the financial position of the firm or to meet an unforeseen liability. For example, General Reserve is to strengthen the financial position while Workmen Compensation Reserve is set aside to meet a claim of staff, if any.

**Partners' Current Accounts are used when Capital Accounts are maintained following Fixed Capital Accounts Method.

Features of Profit and Loss Appropriation Account

1. It is an extension of the Profit and Loss Account.
2. It is prepared by the partnership firms.
3. It shows the appropriation of net profit or loss for the accounting period.
4. Entries in this account are passed giving effect to the Partnership Deed.

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

Basis	*Profit and Loss Account*	*Profit and Loss Appropriation Account*
1. **Stage of Preparation**	It is prepared after Trading Account. It therefore, starts with Gross Profit (in the credit side) or Gross Loss (in the debit side) as per the Trading Account.	It is prepared after Profit and Loss Account. It therefore, starts with Net Profit (in the credit side) or Net Loss (in the debit side) as per the Profit and Loss Account.
2. **Objective**	It is prepared to determine net profit earned or net loss incurred during the accounting year.	It is prepared to show appropriation of net profit, *i.e.*, distribution of Net Profit or Net Loss for the accounting period among the partners.
3. **Nature of Items**	It is debited with the expenses (charge against profit) and credited with the income, not being operating income to determine net profit or loss for the accounting period.	It is debited with the items of appropriation of profit such as salary/commission to partners, interest on capital and transfer to reserve, etc. It is credited with the items of income being debited to Partners' Capital Accounts or Patners' Current Accounts such as interest on drawings.
4. **Partnership Deed or Agreement**	Preparation of this account is not guided by the Partnership Deed or Agreement.	Preparation of this account is guided by the Partnership Deed or Agreement.
5. **Matching Principle**	While preparing this account, Matching Principle (*i.e.,* revenue is matched against expenses) is followed.	While preparing this account, Matching Principle is not followed being not applicable.

Let us understand complete set of final accounts of a partnership firm with the help of following illustration for better understanding of Profit and Loss Appropriation Account.

Illustration 6.

Ayub and Amit are partners in M/s Amrit Papers sharing profits and losses equally. Following trial balance is prepared from the books of account as at 31st March, 2020:

Particulars	Dr. (₹)	Particulars	Cr. (₹)
Opening Stock	45,000	Sales	12,50,000
Purchases	7,60,000	Purchases Return	10,000
Sales Return	25,000	Interest on Loan to Ayub	600
Salary and Wages	1,80,000	Sundry Creditors	70,000
Rent	1,10,000	Loan by Amit	20,000
General Expenses	34,400	Capital Accounts:	
Interest on Loan by Amit	1,200	Ayub	4,00,000
Sundry Debtors	2,00,000	Amit	3,85,000
Furniture and Fixtures	50,000		
Computers	2,20,000		
Machinery	3,00,000		
Loan to Ayub	10,000		
Cash at Bank	75,000		
Cash in Hand	15,000		
Drawings: Ayub	60,000		
Amit	50,000		
	21,35,600		21,35,600

Prepare Trading Account, Profit and Loss Account and Profit and Loss Appropriation Account for the year ended 31st March, 2020 and Balance Sheet as at that date after accounting the following adjustments:

(i) Stock as at 31st March, 2020 was ₹ 50,000;

(ii) Rent is ₹ 10,000 per month, payable to Ayub;

(iii) Depreciate Furniture and Fixtures and Computers @ 20% p.a., Machinery @ 10% p.a.;

(iv) Interest on Capitals is allowed @ 6% p.a.;

(v) Manager's Commission is payable @ 1% of net sales; and

(vi) Interest on Loan by Amit was paid on 31st March, 2020.

Solution:

M/s Amrit Papers

TRADING ACCOUNT

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

Particulars		₹	Particulars		₹
To Opening Stock		45,000	By Sales	12,50,000	
To Purchases	7,60,000		*Less:* Sales Return	25,000	12,25,000
Less: Purchases Return	10,000	7,50,000	By Closing Stock		50,000
To Gross Profit transferred to Profit and Loss Account		4,80,000			
		12,75,000			12,75,000

PROFIT AND LOSS ACCOUNT

for the year ended 31st March, 2020

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Salary and Wages		1,80,000	By Gross Profit—transferred from Trading Account	4,80,000
To Manager's Commission (1% of ₹ 12,25,000)		12,250	By Interest on Loan to Ayub	600
To Rent	1,10,000			
Add: Outstanding Rent	10,000	1,20,000		
To General Expenses		34,400		
To Interest on Loan by Amit		1,200		
To Depreciation on:				
Furniture and Fixtures	10,000			
Computers	44,000			
Machinery	30,000	84,000	**Net Profit**	
To Net Profit transferred to Profit and Loss Appropriation Account		48,750		
		4,80,600		4,80,600

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2020

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Net Profit)	48,750
Ayub	24,000			
Amit	23,100	47,100	**Distributable Profit**	
To Profit transferred to:				
Ayub's Capital A/c	825			
Amit's Capital A/c	825	1,650		
		48,750		48,750

BALANCE SHEET *as at 31st March, 2020*

Liabilities		₹	Assets		₹
Capital A/cs:			Furniture and Fixtures	50,000	
Ayub	4,00,000		*Less:* Depreciation	10,000	40,000
Add: Interest on Capital	24,000		Computers	2,20,000	
Share of Profit	825		*Less:* Depreciation	44,000	1,76,000
	4,24,825		Machinery	3,00,000	
Less: Drawings	60,000	3,64,825	*Less:* Depreciation	30,000	2,70,000
Amit	3,85,000		Sundry Debtors		2,00,000
Add: Interest on Capital	23,100		Loan to Ayub		10,000
Share of Profit	825		Closing Stock		50,000
	4,08,925		Cash at Bank		75,000
Less: Drawings	50,000	3,58,925	Cash in Hand		15,000
Sundry Creditors		70,000			
Loan by Amit		20,000			
Manager's Commission Payable		12,250			
Rent Outstanding		10,000			
		8,36,000			8,36,000

Illustration 7.

A and *B* entered into partnership on 1st April, 2019 without any Partnership Deed. They introduced capitals of ₹ 5,00,000 and ₹ 3,00,000 respectively. On 31st October, 2019, *A* gave ₹ 2,00,000 as loan to the firm without any agreement as to interest.

Profit and Loss Account for the year ended 31st March, 2020 showed a profit of ₹ 4,30,000, but the partners could not agree upon the amount of interest on loan to be charged and the basis of division of profit.

Pass a Journal entry for distribution of the profit between the partners and prepare Capital Accounts of both the partners and Loan Account of *A*. *(AI 2011, Dates Modified)*

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. ₹	Cr. ₹
2020 March 31	Profit and Loss Appropriation A/c ...Dr.		4,25,000	
	To *A*'s Capital A/c			2,12,500
	To *B*'s Capital A/c			2,12,500
	(Profit distributed between *A* and *B* equally) (WN 2)			

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	*A* ₹	*B* ₹	Date	Particulars	*A* ₹	*B* ₹
2020 March 31	To Balance *c/d*	7,12,500	5,12,500	2019 April 1	By Bank A/c	5,00,000	3,00,000
				2020 March 31	By Profit and Loss Appropriation A/c (Profit)	2,12,500	2,12,500
		7,12,500	5,12,500			7,12,500	5,12,500

Dr. LOAN BY *A* ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020 March 31	To Balance *c/d*	2,05,000	2019 Oct. 31	By Bank A/c	2,00,000
			2020 March 31	By Interest on Loan by *A* A/c (WN 1)	5,000
		2,05,000			2,05,000

Working Notes:

1. Interest on Loan by $A = ₹\ 2,00,000 \times \frac{5}{12} \times \frac{6^*}{12} = ₹\ 5,000$

   *Interest on Loan is to be paid @ 6% p.a.

   Since there is no agreement between partners *A* and *B* for interest on loan by partners, the provision of Indian Partnership Act, 1932 will apply. It prescribes that Interest on Loan by Partners is payable @ 6% p.a.
2. Net Profit after Interest on Loan by *A* = ₹ 4,30,000 – ₹ 5,000 = ₹ 4,25,000, which is shared equally because the profit-sharing ratio is not given.

Illustration 8 (*Rent Payable to a Partner and Preparation of Profit and Loss Appropriation Account*).

Aman and Boman are partners sharing profits equally. Business is being carried from the property owned by Aman on a yearly rent of ₹ 24,000. Aman is to get salary of ₹ 1,20,000 p.a. and Boman is to get commission @ 5% of net sales, which during the year was ₹ 30,00,000. Profit for the year ended 31st March, 2020 before providing for rent was ₹ 5,00,000.

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

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	Particulars	₹
To Aman's Capital A/c (Salary)		1,20,000	By Profit and Loss A/c (Net Profit)	4,76,000
To Boman's Capital A/c (Commission)		1,50,000		
To Profit transferred to:				
Aman's Capital A/c	1,03,000			
Boman's Capital A/c	1,03,000	2,06,000		
		4,76,000		4,76,000

Note: ₹ 24,000 is the rent which is charge against the profit and hence debited to Profit and Loss Account. Thus, amount of Profit available for appropriation is ₹ 4,76,000 (*i.e.*, ₹ 5,00,000 – ₹ 24,000).

Illustration 9 (*Profit and Loss Appropriation Account*).

Aseem and Nihar started business on 1st April, 2019 with capitals of ₹ 3,00,000 and ₹ 2,00,000 respectively. According to the Partnership Deed, Nihar is to get salary of ₹ 5,000 per month, Aseem is to get 10% commission on Profit after allowing salary to Nihar and interest is to be allowed on capitals @ 6% p.a. Profit-sharing ratio between the two partners is 3 : 2. During the year, the firm earned profit of ₹ 2,50,000.

Aseem had given loan of ₹ 1,00,000 to the firm on 1st April, 2019. Interest on loan was allowed @ 8% p.a. Nihar was given loan of ₹ 2,00,000 on which interest was charged ₹ 11,000. Manager was to be allowed commission of ₹ 3,000.

Pass Journal entries for distribution of profit and prepare Profit and Loss Appropriation Account. The firm closes its books of account on 31st March every year.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020				
March 31	Profit and Loss A/c ...Dr.		2,50,000	
	To Profit and Loss Appropriation A/c			2,50,000
	(Transfer of net profit to Profit and Loss Appropriation Account)			
March 31	Nihar's Salary A/c ...Dr.		60,000	
	To Nihar's Capital A/c			60,000
	(Salary due to Nihar @ ₹ 5,000 per month)			

March 31	Aseem's Commission A/c ...Dr.		19,000	
	To Aseem's Capital A/c			19,000
	(Commission due to Aseem)			
March 31	Profit and Loss Appropriation A/c ...Dr.		79,000	
	To Nihar's Salary A/c			60,000
	To Aseem's Commission A/c			19,000
	(Salary and commission to Partners transferred to Profit and Loss Appropriation Account)			
March 31	Interest on Capital A/c ...Dr.		30,000	
	To Aseem's Capital A/c			18,000
	To Nihar's Capital A/c			12,000
	(Interest on capitals allowed to partners @ 6% p.a.)			
March 31	Profit and Loss Appropriation A/c ...Dr.		30,000	
	To Interest on Capital A/c			30,000
	(Interest on capitals transferred to Profit and Loss Appropriation Account)			
March 31	Profit and Loss Appropriation A/c ...Dr.		1,41,000	
	To Aseem's Capital A/c (₹ 1,41,000 × 3/5)			84,600
	To Nihar's Capital A/c (₹ 1,41,000 × 2/5)			56,400
	(Distribution of profit among the partners)			

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	Particulars	₹
To Salary—Nihar's Capital A/c		60,000	By Profit and Loss A/c (Net Profit)	2,50,000
To Commission—Aseem's Capital A/c		19,000	(₹ 2,50,000 – ₹ 8,000 + ₹ 11,000 – ₹ 3,000)	
To Interest on Capital—Aseem's Capital A/c		18,000		
To Interest on Capital— Nihar's Capital A/c		12,000		
To Profit transferred to:				
Aseem's Capital A/c (3/5)	84,600			
Nihar's Capital A/c (2/5)	56,400	1,41,000		
		2,50,000		2,50,000

Illustration 10 (*Profit and Loss Appropriation Account*).

X and *Y* started business on 1st April, 2019 with capitals of ₹ 5,00,000 each. As per the Partnership Deed, both *X* and *Y* are to get monthly salary of ₹ 10,000 each and interest on capitals is ₹ 50,000 each. Interest on Drawings are: *X*— ₹ 3,000 and *Y*—₹ 5,000.

During the year, the firm incurred a loss of ₹ 2,00,000.

Pass Journal entries for the above and prepare Profit and Loss Appropriation Account. The firm closes its accounts on 31st March, every year.

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2020					
March 31	Profit and Loss Appropriation A/c	...Dr.		2,00,000	
	To Profit and Loss A/c				2,00,000
	(Transfer of net loss)				
March 31	*X*'s Capital A/c	...Dr.		3,000	
	Y's Capital A/c	...Dr.		5,000	
	To Interest on Drawings A/c				8,000
	(Interest charged on drawings)				
March 31	Interest on Drawings A/c	...Dr.		8,000	
	To Profit and Loss Appropriation A/c				8,000
	(Interest on drawings transferred to Profit and Loss Appropriation A/c)				
March 31	*X*'s Capital A/c	...Dr.		96,000	
	Y's Capital A/c	...Dr.		96,000	
	To Profit and Loss Appropriation A/c				1,92,000
	(Loss transferred to Partners' Capital Accounts)				

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars	₹	Particulars		₹
To Profit and Loss A/c (Net Loss)	2,00,000	By Interest on Drawings A/cs:		
		X	3,000	
		Y	5,000	8,000
		By Loss transferred to:		
		X's Capital A/c	96,000	
		Y's Capital A/c	96,000	1,92,000
	2,00,000			2,00,000

Note: Salary to partners and interest on capitals are not allowed because the firm has incurred loss.

Appropriations are more than Available Profit

It is also a possibility that total amount of appropriation as per the Deed is more than the amount of profit available for appropriation. In this situation, profit available for distribution among partners is distributed in the ratio of appropriation to be made. The ratio of appropriation is determined as follows:

(i) Determine the amount payable as appropriation to each partner as per the Partnership Deed (ignoring the profit available for distribution among partners). For example, salary payable, commission payable and interest on capital, etc., payable to each partner is determined.

(ii) Total the amount of appropriation (as per Step (i) above) for each partner separately.

(iii) Ratio of the Appropriations (as per Step (ii) above) is the ratio in which profit is appropriated.

It should be kept in mind that no particular item like salary, commission, interest on capital, etc., has priority over other items of appropriation.

Let us take an example for more clarity. Atul and Amit are partners in a firm. As per the Partnership Deed the partners are to get salary of ₹ 1,00,000 and ₹ 1,20,000 p.a. respectively and interest on capital @ 10% p.a. which is ₹ 20,000 and ₹ 40,000 respectively. Net profit for the year ₹ 2,10,000 will be appropriated in the ratio of 3 : 4 calculated as follows:

	Atul (₹)		Amit (₹)
Salary	1,00,000		1,20,000
Interest on Capital	20,000		40,000
Total Amount of Appropriation	1,20,000		1,60,000
Therefore, the Ratio of Appropriation is	₹ 1,20,000	:	₹ 1,60,000
Or	3	:	4

Thus, ₹ 90,000 (*i.e.*, 3/7 of ₹ 2,10,000) and ₹ 1,20,000 (*i.e.*, 4/7 of ₹ 2,10,000) being the total of appropriations for Atul and Amit respectively.

Illustration 11 (*Appropriations are more than Available Profit*).

Ajay and Vijay are partners sharing profits in the ratio of 3 : 2. Ajay is a non-working partner and contributes ₹ 20,00,000 as his capital. Vijay is a working partner of the firm. The Partnership Deed provides for interest on capital @ 8% p.a. and salary to every working partner @ ₹ 8,000 per month. Profit before providing for interest on capital and partner's salary for the year ended 31st March, 2020 was ₹ 80,000. Show the distribution of profit.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars	₹	Particulars	₹
To Ajay's Capital A/c (Interest on capital)	50,000	By Profit and Loss A/c (Net Profit)	80,000
To Vijay's Capital A/c (Salary)	30,000		
	80,000		80,000

Note: Interest on Ajay's Capital = ₹ 20,00,000 × 8/100 = ₹ 1,60,000; Salary to Vijay = ₹ 8,000 × 12 = ₹ 96,000; Thus, Interest on Ajay's Capital + Salary to Vijay = ₹ 1,60,000 + ₹ 96,000 = ₹ 2,56,000.

Since both interest on capital and salary to partners are appropriations and the profit available for distribution is ₹ 80,000, *i.e.*, less than the amount of appropriations to be made, the available profit is distributed in the ratio of appropriations to be made to Ajay and Vijay, *i.e.*,
₹ 1,60,000 (interest on capital): ₹ 96,000 (salary), or 5 : 3.

Special Aspects of Partnership Accounts

In Partnership Accounts, there are some aspects that require discussion. They are:

1. Partners' Capital Accounts;
2. Remuneration (Salary or Commission) to Partners;
3. Interest on Partners' Capitals;
4. Interest on Partners' Drawings;
5. Adjustments for Incorrect Appropriations of Profits in the Past (Past Adjustments); and
6. Guarantee of Profit.

Let us discuss each of these aspects in detail.

1. PARTNERS' CAPITAL ACCOUNTS

A partnership firm has more than one owners (partners) and Capital Account is maintained for each partner separately. It is so because each partner has separate transactions with the firm. For example, if *Atul, Amit and Akhil* are three partners in a firm, there shall be three Capital Accounts, one each for *Atul, Amit and Akhil.*

The Partners' Capital Accounts may be maintained by following either:

(i) Fixed Capital Accounts Method; or
(ii) Fluctuating Capital Accounts Method.

Fixed Capital Accounts Method

Fixed Capital means capital invested by each partner in the firm remains fixed or unaltered, unless a partner introduces additional capital or withdraws out of his or her capital. When Fixed Capital Accounts Method is followed, two accounts, *i.e.*, a Capital Account and a Current Account for each partner are maintained.

Capital Account: Capital Account of each partner continues to show same balance year after year and changes only if additional capital is introduced, which is credited to Capital Account, withdrawal is made out of capital, which is debited to the Capital Account.

Current Account: Current Account is maintained to record transactions other than transactions of capital such as drawings against profit, interest allowed on capital, interest charged on drawings, salary or commission payable to a partner, share of profits/losses. As a result, the balance of Current Account fluctuates with every transaction with the partner.

Current Account of each partner is **debited** by the amount of:

(i) his drawings against profit;
(ii) interest on drawings;
(iii) share of loss; and
(iv) transfer of amount to Capital Account.

Note: Please note that Drawings against Capital is debited to Partner's Capital Account.

Similarly, Current Account of each partner is **credited** by the amount of:

(i) interest on Capital;
(ii) remuneration (Salary or commission);
(iii) share of Profit; and
(iv) transfer of amount from Capital Account.

It should be kept in mind that Partner's Current Account may have a credit or debit balance.

The balances of Partners' Capital Accounts are shown in the liabilities side of the Balance Sheet, as that much amount is due to them. Credit balance in Current Account is shown in the liabilities side and debit balance in the assets side of the Balance Sheet.

Outline of the two accounts maintained under the Fixed Capital Accounts Method are:

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Cash/Bank A/c (Drawings against Capital)	...	...	...	By Balance *b/d*	...	...	...
				By Cash/Bank A/c (Additional capital)	...	...	...
To Balance *c/d*	...	...	...				
	...	...	...		...	...	...

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)	Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
To Balance *b/d* (In case of debit opening balance)	...	...	...	By Balance *b/d* (In case of credit opening balance)	...	...	...
To Drawings A/c (Drawings against Profit)	...	...	...	By Interest on Capital A/c	...	...	...
				By Commission A/c	...	...	...
To Interest on Drawings A/c	...	...	...	By Partner's Salary A/c	...	...	...
To Profit and Loss A/c (Loss)	...	...	...	By Profit and Loss App. A/c (Profit)	...	...	...
To Balance *c/d**	...	...	...				
	...	...	...		...	...	...

*The balance may be on the opposite (credit) side if the amount is overdrawn.

Fluctuating Capital Accounts Method

Under Fluctuating Capital Accounts Method only one account namely 'Capital Account' is maintained for each partner.

All transactions of a partner (*e.g.*, capital introduced or withdrawn), salary or commission allowed, interest allowed on capital, drawings (against profit), interest charged on drawings, share of profit or loss, etc., are transferred to his Capital Account. As a result, balance in the Capital Account fluctuates with every transaction.

Capital Accounts having credit balances are shown in the liabilities side while Capital Accounts having debit balances are shown in the assets side of the Balance Sheet.

Fluctuating Capital Accounts Method is normally followed for maintaining Capital Accounts.

In the absence of any instruction or information, it is assumed that Fluctuating Capital Accounts Method is followed for maintaining the Partners' Capital Accounts.

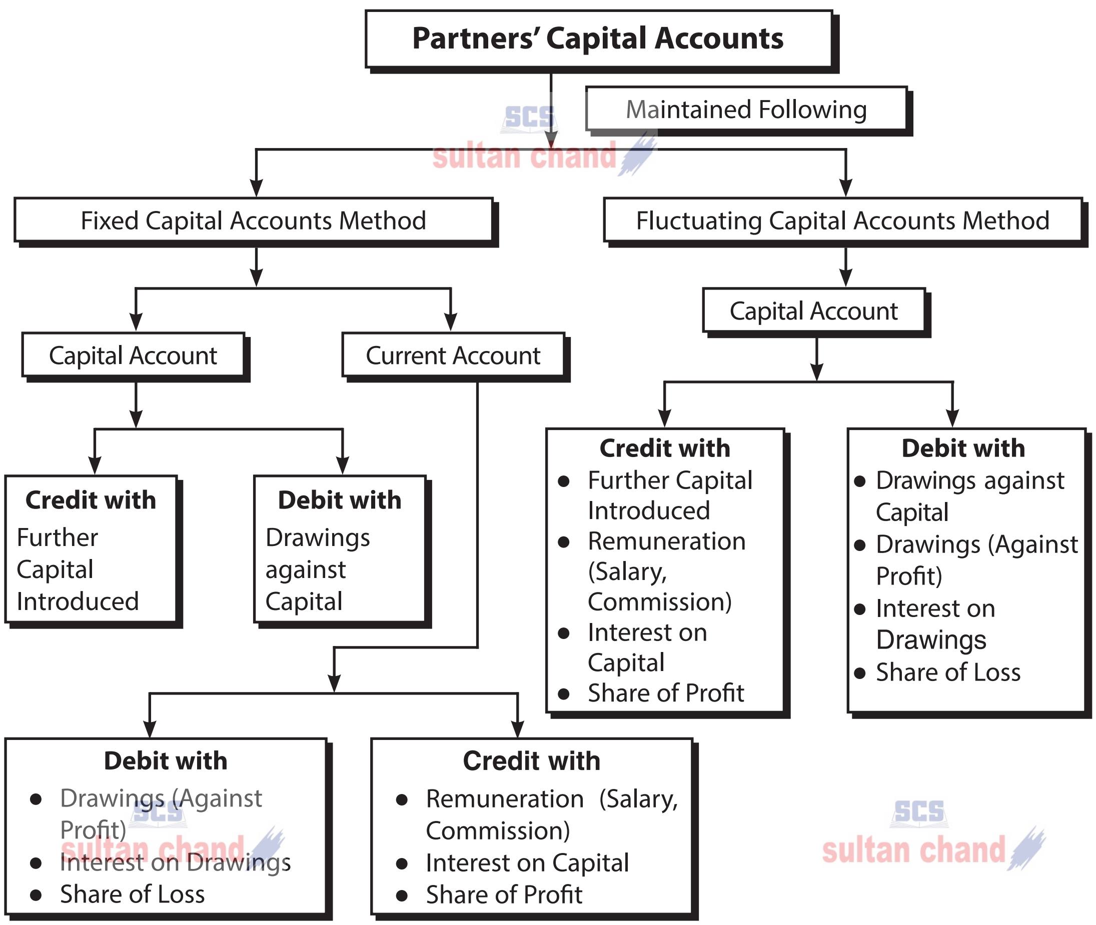
Outline of the Capital Account under Fluctuating Capital Accounts Method is as follows:

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Balance *b/d* (In case of debit opening balance)	...	...	...	By Balance *b/d* (In case of credit opening balance)	...	...	...
To Cash/Bank A/c (Drawings against Capital)	...	...	...	By Cash/Bank A/c (Additional Capital)	...	...	...
To Drawings A/c (Drawings against Profit)	...	...	...	By Interest on Capital A/c	...	...	...
				By Commission A/c	...	...	...
To Interest on Drawings A/c	...	...	...	By Partner's Salary A/c	...	...	...
To Profit and Loss A/c (Loss)	...	...	...	By Profit and Loss App. A/c (Profit)	...	...	...
To Balance *c/d**	...	...	...				
	...	...	...		...	...	...

*The balance may be on the opposite (credit) side also.

Pictorial Depiction of Methods of Maintaining Partners' Capital Accounts with Items Debited and Credited



Difference between Fixed Capital Account and Fluctuating Capital Account

Basis	*Fixed Capital Account*	*Fluctuating Capital Account*
1. **No. of Accounts Maintained**	**Two** accounts are maintained for each partner, *i.e.*, Fixed Capital Account and Current Account.	**One** account (*i.e.*, Capital Account) is maintained for each partner.
2. **Frequency of Change**	Balance in Fixed Capital Account **does not change** except when further capital is introduced or capital is withdrawn.	Balance **changes** with every transaction of the partner with the firm.
3. **Transferring the Transactions**	Transactions relating to **Capitals** are transferred to Fixed Capital Accounts and transactions for drawings, interest on drawings, interest on capital, salary, commission, share of profit or loss are transferred to **Current Account**.	All transactions whether for capital, drawings, interest on drawings, interest on capital, salary, commission, share of profit or loss are transferred to **Capital Account**.
4. **Balance**	Capital Account has **credit balance**.	Fluctuating Capital Account may have **credit** or **debit balance**.

Difference between Capital Account and Current Account

Basis	*Capital Account*	*Current Account*
1. **Need**	Capital Account is maintained in all the cases, whether following Fixed Capital Accounts Method or Fluctuating Capital Accounts Method.	Current Account is maintained when Fixed Capital Accounts method is followed.
2. **Balance of Account**	Capital Account will always have a credit balance when Fixed Capital Accounts Method is followed. In Fluctuating Capital Accounts Method, it may have either credit or debit balance.	Balance of a Current Account may have a credit or debit balance.
3. **Nature**	In case of fixed capital, Capital Account balance generally remains unchanged from year to year. It changes when further capital is introduced or capital is withdrawn by a partner.	Balance of Current Account does not change when capital is introduced or withdrawn by a partner.
4. **Transactions**	Capital Account records the amount invested by a partner in the firm.	Current Account records the transactions such as drawings, interest on capital, interest on drawings, salary, commission, profit or loss, etc.

Illustration 12

The Partnership Deed provided that Sonu was to be paid a salary of ₹ 20,000 per month and Rajat a commission of 5% on turnover. It also provided that interest on capital be allowed @ 8% p.a. Sonu withdrew ₹ 20,000 on 1st December, 2017 and Rajat withdrew ₹ 5,000 at the end of each month. Interest on drawings was charged @ 6% p.a. The net profit as per Profit and Loss Account for the year ended 31st March, 2018 was ₹ 4,89,950. The turnover of the firm for the year ended 31st March, 2018 amounted to ₹ 20,00,000.

Pass necessary Journal entries for the above transactions in the books of Sonu and Rajat.

(CBSE 2019)

Solution:

JOURNAL

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
(i)	Profit and Loss A/c	...Dr.		4,89,950	
	To Profit and Loss Appropriation A/c				4,89,950
	(Profit transferred from Profit and Loss Account to Profit and Loss Appropriation Account)				
(ii)	Partner's Salary A/c	...Dr.		2,40,000	
	To Sonu's Capital A/c				2,40,000
	(Salary credited to Sonu's Capital Account)				
(iii)	Profit and Loss Appropriation A/c	...Dr.		2,40,000	
	To Partner's Salary A/c				2,40,000
	(Salary transferred to Profit and Loss Appropriation Account)				
(iv)	Partner's Commission A/c	...Dr.		1,00,000	
	To Rajat's Capital A/c				1,00,000
	(Commission credited to Rajat's Capital Account)				
(v)	Profit and Loss Appropriation A/c	...Dr.		1,00,000	
	To Partner's Commission A/c				1,00,000
	(Commission transferred to Profit and Loss Appropriation Account)				
(vi)	Interest on Capital A/c	...Dr.		1,12,000	
	To Sonu's Capital A/c				64,000
	To Rajat's Capital A/c				48,000
	(Interest on capital credited to Partners' Capital Accounts)				
(vii)	Profit and Loss Appropriation A/c	...Dr.		1,12,000	
	To Interest on Capital A/c				1,12,000
	(Interest on Capital transferred to Profit and Loss Appropriation Account)				
(viii)	Sonu's Capital A/c	...Dr.		400	
	Rajat's Capital A/c	...Dr.		1,650	
	To Interest on Drawings A/c				2,050
	(Interest on drawings charged) (Note 1)				
(ix)	Interest on Drawings A/c	...Dr.		2,050	
	To Profit and Loss Appropriation A/c				2,050
	(Interest on drawings transferred to Profit and Loss Appropriation Account)				
(x)	Profit and Loss Appropriation A/c	...Dr.		40,000	
	To Sonu's Capital A/c				24,000
	To Rajat's Capital A/c				16,000
	(Profit credited to Partners' Capital Accounts) (Note 2)				

Notes:

1. *Calculation of Interest on Drawings:*

   Interest on Sonu's Drawings = ₹ 20,000 × 6/100 × 4/12 = ₹ 400

   Total Drawings of Rajat = ₹ 5,000 × 12 = ₹ 60,000

   Interest on Rajat's Drawings = ₹ 60,000 × 6/100 × 5.5/12 = ₹ 1,650.

2. *Calculation of Distributable Profit from Profit and Loss Appropriation Account:*

   = ₹ 4,89,950 + ₹ 2,050 – ₹ 2,40,000 – ₹ 1,00,000 – ₹ 1,12,000 = ₹ 40,000.

Illustration 13 (*When Capitals are Fixed and Fluctuating*).

A and *B* are partners with capitals of ₹ 60,000 and ₹ 20,000 respectively on 1st April, 2019. Net profit (before giving effect to the Partnership Deed) for the year ended 31st March, 2020 was ₹ 24,000. The Partnership Deed provides for the following:

(a) *B* is to get salary of ₹ 6,000 p.a.

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

(c) Interest on drawings is to be charged @ 5% p.a.

Drawings of the partners *A* and *B* were ₹ 6,000 and ₹ 4,000 respectively and interest on drawings for *A* being ₹ 200 and for *B* ₹ 100.

Show how profit will be distributed between *A* and *B* and also prepare the Capital Accounts of the partners along with their Drawings Accounts:

(i) if they are fixed, and (ii) if they are fluctuating.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2020

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Net Profit)		24,000
A (6% on ₹ 60,000)	3,600		By Interest on Drawings A/cs:		
B (6% on ₹ 20,000)	1,200	4,800	*A*	200	
To *B*'s Salary A/c		6,000	*B*	100	300
To Profit transferred to:					
(Equal share of profit)*					
A's Capital/Current** A/c	6,750				
B's Capital/Current** A/c	6,750	13,500			
		24,300			24,300

*Profit is to be shared equally because profit-sharing ratio is not given. **In case of fixed capitals.

(i) *Fixed Capitals*

Dr. *A*'S CAPITAL ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020			2019		
March 31	To Balance *c/d*	60,000	April 1	By Balance *b/d*	60,000

Dr. *B*'S CAPITAL ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020			2019		
March 31	To Balance *c/d*	20,000	April 1	By Balance *b/d*	20,000

Dr. *A*'S CURRENT ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020			2020		
March 31	To *A*'s Drawings A/c	6,000	March 31	By Interest on Capital A/c	3,600
March 31	To Interest on Drawings A/c	200	March 31	By Profit and Loss App. A/c	6,750
March 31	To Balance *c/d*	4,150		—Profit (1/2)	
		10,350			10,350

Dr. *B*'S CURRENT ACCOUNT *Cr.*

Date	Particulars	₹	Date	Particulars	₹
2020			2020		
March 31	To *B*'s Drawings A/c	4,000	March 31	By Interest on Capital A/c	1,200
March 31	To Interest on Drawings A/c	100	March 31	By *B*'s Salary A/c	6,000
March 31	To Balance *c/d*	9,850	March 31	By Profit and Loss App. A/c	6,750
				—Profit (1/2)	
		13,950			13,950

Dr. *A'S* DRAWINGS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2020 March 31	To Cash/Bank A/c	6,000	2020 March 31	By *A's* Current A/c	6,000

Dr. *B'S* DRAWINGS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2020 March 31	To Cash/Bank A/c	4,000	2020 March 31	By *B's* Current A/c	4,000

(ii) *Fluctuating Capitals*

Dr. *A'S* CAPITAL ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2020			2019		
March 31	To *A's* Drawings A/c	6,000	April 1	By Balance *b/d*	60,000
March 31	To Interest on Drawings A/c	200	2020		
March 31	To Balance *c/d*	64,150	March 31	By Interest on Capital A/c	3,600
			March 31	By Profit and Loss App. A/c —Profit (1/2)	6,750
		70,350			70,350

Dr. *B'S* CAPITAL ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2020			2019		
March 31	To *B's* Drawings A/c	4,000	April 1	By Balance *b/d*	20,000
March 31	To Interest on Drawings A/c	100	2020		
March 31	To Balance *c/d*	29,850	March 31	By Interest on Capital A/c	1,200
			March 31	By *B's* Salary A/c	6,000
			March 31	By Profit and Loss App. A/c —Profit (1/2)	6,750
		33,950			33,950

Dr. *A'S* DRAWINGS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2020 March 31	To Cash/Bank A/c	6,000	2020 March 31	By *A's* Capital A/c	6,000

Dr. *B'S* DRAWINGS ACCOUNT Cr.

Date	Particulars	₹	Date	Particulars	₹
2020 March 31	To Cash/Bank A/c	4,000	2020 March 31	By *B's* Capital A/c	4,000

2. REMUNERATION (SALARY OR COMMISSION) TO PARTNERS

Remuneration (Salary or Commission) is allowed to the partners for looking after the business of the firm. It is allowed only if the Partnership Deed provides to allow it. Stating differently, if the Partnership Deed does not exist or if it exists but does not provide for allowing salary and commission, it is not allowed.

Nature

Salary or commission to partners is allowed only if the Partnership Deed allows it *and* also if the firm earns profit during the year. Salary or commission to a partner is an **appropriation** of profit, and **not a charge** against profit.

Salary payable to each partner is normally stated as an amount. But, Commission payable to a partner is stated as percentage of profit, which may be allowed to the partners either:

(i) as a percentage of net profit or distributable profit *before* charging commission; or

(ii) as a percentage of net profit or distributable profit *after* charging commission.

Commission, under the two methods, is computed as follows:

(i) *Percentage of Net Profit or Distributable Profit before charging Commission:*

$$\text{Net Profit or Distributable Profit (before Commission)} \times \frac{\text{Rate of Commission}}{100}$$

(ii) *Percentage of Net Profit or Distributable Profit after charging Commission:*

$$\text{Net Profit or Distributable Profit (before Commission)} \times \frac{\text{Rate of Commission}}{100 + \text{Rate of Commission}}$$

Accounting Treatment

Remuneration (Salary or Commission) to partners, being an appropriation of profit, is transferred to **Profit and Loss Appropriation Account**. Journal entries passed are:

(i) *On Allowing Remuneration (Salaries or Commission) to Partners:*

Partners' Salaries/Commission A/c ...Dr.
  To Partners' Current A/cs [When Capitals are fixed]
  To Partners' Capital A/cs [When Capitals are fluctuating]

(ii) *On Closure of Remuneration (Salaries or Commission) A/cs:*

Profit and Loss Appropriation A/c ...Dr.
  To Partners' Salaries/Commission A/c

Illustration 14 (*Commission to Partners and Distribution of Profit*).

X and *Y* are partners in a firm. *X* is to get commission of 10% of net profit before charging any commission. *Y* is to get a commission of 10% on net profit after charging all commissions. Net Profit for the year ended 31st March, 2020 was ₹ 55,000.

Find the commission of *X* and *Y*. Also, show the distribution of profit.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2020

Dr. | | | | | Cr.

Particulars		₹	Particulars	₹
To *X*'s Commission A/c (₹ 55,000 × 10/100)		5,500	By Profit and Loss Account (Net Profit)	55,000
To *Y*'s Commission A/c (Note) [(₹ 55,000 – ₹ 5,500) × 10/110]		4,500		
To Profit transferred to Capital A/cs:				
X	22,500			
Y	22,500	45,000		
		55,000		55,000

Note: The above stated amount of *Y*'s Commission can be verified. After charging all commissions, net profit comes to ₹ 45,000 [*i.e.*, ₹ 55,000 – (₹ 5,500 + ₹ 4,500)]. Thereafter, calculate *Y*'s Commission @ 10% of ₹ 45,000.

3. INTEREST ON PARTNERS' CAPITALS

Interest on Capital is allowed to compensate a partner for contributing capital to the firm in excess of the profit-sharing ratio. Like interest on drawings, it is also calculated at the agreed rate with reference to the time capital has been used in the business. Thus, interest on capital is allowed on the opening balance of the partner's capital.

Additional Capital: If additional capital is introduced during the year, interest is allowed on it from the date additional capital is introduced till the end of the accounting year.

Withdrawal of Capital: If capital is withdrawn by a partner during the year and interest is allowed on capital, interest is not allowed on the amount withdrawn from the date of withdrawal of capital till the end of the accounting year.

Example

Alok, a partner had capital of ₹ 5,00,000 as on 1st April, 2019. He introduced additional capital of ₹ 2,00,000 on 1st October, 2019 and withdrew ₹ 1,00,000 on 1st January, 2020. If interest on capital is allowed @ 10% p.a., interest on capital will be ₹ 57,500, calculated as follows:

	₹
Interest on ₹ 5,00,000 @ 10% p.a. for 6 months (1st April, 2019 to 30th September, 2019)	25,000
Interest on ₹ 7,00,000 @ 10% p.a. for 3 months (₹ 5,00,000 + ₹ 2,00,000) (1st October, 2019 to 31st December, 2019)	17,500
Interest on ₹ 6,00,000 @ 10% p.a. for 3 months (₹ 7,00,000 – ₹ 1,00,000) (1st January, 2020 to 31st March, 2020)	15,000
Total Interest	57,500

Reasons or justification for allowing interest on capital are:

(i) When Capitals of partners are different but profit share is equal. If a partner invests more capital as compared to other partners and profit share is equal, interest paid on capital compensates him or her for more investment. In case interest on capital is not paid, share in profit of a partner investing more capital will be equal to share of profit of partners investing less capital.

(ii) When Capitals of partners are not same and profit share is also not equal. In this case, partners investing less capital may get more share of profit and partners investing more capital may get less share of profit.

(iii) Capital increases the earning capacity of the firm. Capital is the most important component of business. Capital helps in efficient conduct of business activities and therefore earning more profits. It is because of this reason that interest on capital is allowed.

At the same time, where profit is shared by the partners in the proportion of their capitals, interest on capital should not be allowed because partner investing more capital gets more share of profit.

The provisions relating to interest on capital are given below:

PROVISION RELATING TO INTEREST ON CAPITAL

Case	*Provision*
1. **When the Partnership Deed does not exist or Partnership Deed does not provide for interest on capital.**	1. Interest on capital *is not allowed*.
2. **When the Partnership Deed provides for interest on capital but is silent on whether interest is a *charge* or *appropriation*.**	2. Interest on capital is accounted as appropriation of profit. Interest on capital is allowed only if there is profit. There are three possible situations as follows: (i) **Situation 1:** Loss is incurred — Interest on capital is *not allowed*. (ii) **Situation 2:** Profit before interest is equal to or more than the interest. — Interest on capital is *allowed at the agreed rate*. (iii) **Situation 3:** Profit before interest is less than the interest. — Interest is *allowed only to the extent of profit* in the ratio of interest on capital of each partner.
3. **When the Partnership Deed provides for interest on capital as a charge (*i.e.,* to be allowed whether there are profits or losses).**	3. Interest on capital is *allowed* whether the firm has earned profit or has incurred loss.

Journal entries to record interest on capital are:

If Partners' Capital Accounts are fixed.	*If Partners' Capital Accounts are fluctuating.*
(i) Interest on Capital A/c ...Dr. To Partners' Current A/cs (Interest on capital allowed to partners)	(i) Interest on Capital A/c ...Dr. To Partners' Capital A/cs (Interest allowed on partners' capitals)
(ii) Profit and Loss Appropriation A/c ...Dr. To Interest on Capital A/cs (Interest on capital transferred to Profit and Loss Appropriation Account)	(ii) Profit and Loss Appropriation A/c ...Dr. To Interest on Capital A/cs (Interest on capital transferred to Profit and Loss Appropriation Account)

Illustration 15.

X and *Y* are partners sharing profits and losses in the ratio of 2 : 3 with capitals of ₹ 2,00,000 and ₹ 1,00,000 respectively. Pass the necessary Journal entry or entries for distribution of profit/loss for the year ended 31st March, 2020 in each of the alternative cases:

Case 1. If Partnership Deed does not provide for interest on capital and the profit for the year is ₹ 20,000.

Case 2. If Partnership Deed provides for interest on capital @ 6% p.a. and loss for the year is ₹ 15,000.

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

Case 4. If Partnership Deed provides for interest on capital @ 6% p.a. as a charge on profit and the profit for the year is ₹ 20,000.

Case 5. If Partnership Deed provides for interest on capital @ 6% p.a. as a charge on profit and the profit for the year is ₹ 2,000.

Case 6. If Partnership Deed provides for interest on capital @ 6% p.a. as a charge on profit and the profit for the year is ₹ 18,000.

Solution: JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020	**Case 1**			
March 31	Profit and Loss A/c ...Dr.		20,000	
	To Profit and Loss Appropriation A/c			20,000
	(Net profit transferred to Profit and Loss Appropriation Account)			
	Profit and Loss Appropriation A/c ...Dr.		20,000	
	To *X*'s Capital A/c			8,000
	To *Y*'s Capital A/c			12,000
	(Profit distributed between *X* and *Y* in the ratio of 2 : 3)			
	Case 2			
	X's Capital A/c ...Dr.		6,000	
	Y's Capital A/c ...Dr.		9,000	
	To Profit and Loss A/c			15,000
	(Loss distributed between *X* and *Y* in the ratio of 2 : 3)			
	Note: Due to loss, interest on capital is not allowed.			
	Case 3			
	Profit and Loss A/c ...Dr.		21,000	
	To Profit and Loss Appropriation A/c			21,000
	(Net profit transferred to Profit and Loss Appropriation Account)			
	Interest on Capital A/c ...Dr.		18,000	
	To *X*'s Capital A/c			12,000
	To *Y*'s Capital A/c			6,000
	(Interest on capital allowed to Partners @ 6% p.a.)			
	Profit and Loss Appropriation A/c ...Dr.		18,000	
	To Interest on Capital A/c			18,000
	(Interest on capital transferred)			
	Profit and Loss Appropriation A/c ...Dr.		3,000	
	To *X*'s Capital A/c			1,200
	To *Y*'s Capital A/c			1,800
	(Profit distributed between *X* and *Y* in the ratio of 2 : 3)			
	Case 4			
	Interest on Capital A/c ...Dr.		18,000	
	To *X*'s Capital A/c			12,000
	To *Y*'s Capital A/c			6,000
	(Interest on capital allowed @ 6% p.a.)			

Profit and Loss A/c ...Dr.		18,000	
To Interest on Capital A/c			18,000
(Interest on capital transferred to Profit and Loss Account)			
Profit and Loss A/c ...Dr.		2,000	
To Profit and Loss Appropriation A/c			2,000
(Net profit transferred to Profit and Loss Appropriation Account)			
Profit and Loss Appropriation A/c ...Dr.		2,000	
To *X*'s Capital A/c			800
To *Y*'s Capital A/c			1,200
(Profit distributed between *X* and *Y* in the ratio of 2 : 3)			
Case 5			
Interest on Capital A/c ...Dr.		18,000	
To *X*'s Capital A/c			12,000
To *Y*'s Capital A/c			6,000
(Interest on capital allowed @ 6% p.a.)			
Profit and Loss A/c ...Dr.		18,000	
To Interest on Capital A/c			18,000
(Interest on capital transferred to Profit and Loss Account being a charge)			
X's Capital A/c ...Dr.		6,400	
Y's Capital A/c ...Dr.		9,600	
To Profit and Loss A/c (₹ 18,000 – ₹ 2,000)			16,000
(Net loss transferred to Capital Accounts of *X* and *Y* in their profit-sharing ratio)			
Case 6			
Interest on Capital A/c ...Dr.		18,000	
To *X*'s Capital A/c			12,000
To *Y*'s Capital A/c			6,000
(Interest on capital allowed as a charge on profit @ 6% p.a.) (Note)			
Profit and Loss A/c ...Dr.		18,000	
To Interest on Capital A/c			18,000
(Interest on capital transferred to Profit and Loss Account)			

Note: Case 6: Profit and Loss Appropriation Account will not be prepared because interest on capital is a charge against profit and hence is debited to Profit and Loss Account. After allowing interest on capital, it results in neither profit nor loss.

Interest on Capital when Profit Available for Appropriation is Inadequate

Profit of the firm may be less than the amount of interest on capitals allowable to the partners and interest on capital is an appropriation. In this situation, interest on capitals of the partners is calculated and the profit is distributed among the partners in the ratio of interest on capital.

In case, along with interest on capital, appropriation is to be made for salary, commission, etc., to partners, total amount of appropriations for *each partner* is determined and amount of profit is distributed among the partners in the ratio of the appropriations to be made to each partner. Following illustration will bring more clarity.

Illustration 16 (*Interest on Capital when Profit is Inadequate*).

A and *B* have capitals of ₹ 4,00,000 and ₹ 2,00,000 respectively and interest on capital is to be allowed @ 6% p.a. Their profit-sharing ratio is 2 : 3 and profit (before interest) for the year is ₹ 30,000. Prepare Profit and Loss Appropriation Account to distribute the profit.

Solution:

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended...* Cr.

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

Working Note: The interest on *A*'s Capital and *B*'s Capital is ₹ 24,000 and ₹ 12,000 respectively. Thus, total interest on capital is ₹ 36,000. Profit before interest is ₹ 30,000. The interest on capital will be allowed as follows:

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

Remember: Interest on capital is allowed to the extent of available profit only, since interest on capital is an appropriation of profit.

In case, interest on capital is a charge, *i.e.*, it is to be allowed whether the firm earns profit or incurs loss. Net profit is determined after allowing interest on capital, which is transferred to Profit and Loss Appropriation Account to be distributed among partners in their profit-sharing ratio. Following illustration explains it further.

Illustration 17.

Atul and Bhaskar are partners sharing profits in the ratio of 2 : 3. Their capitals are ₹ 4,00,000 and ₹ 2,00,000 respectively. Interest is to be allowed on capitals @ 6% p.a. Profit before allowing interest on capitals is ₹ 30,000.

Prepare Profit and Loss Appropriation Account to distribute profit or loss, if interest on capitals is a charge.

Solution:

Dr. PROFIT AND LOSS ACCOUNT *for the year ended ...* Cr.

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit (Before Interest)	30,000
Atul	24,000		By Net Loss transferred to	
Bhaskar	12,000	36,000	Profit and Loss Appropriation A/c	6,000
		36,000		36,000

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended ...* Cr.

Particulars	₹	Particulars		₹
To Profit and Loss A/c	6,000	By Loss transferred to Capital A/cs:		
		Atul	2,400	
		Bhaskar	3,600	6,000
	6,000			6,000

Alternatively:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended ...

Dr. Particulars	₹	Particulars	*Cr.* ₹
To Net Loss transferred from Profit and Loss A/c (₹ 30,000 – ₹ 24,000 – ₹ 12,000)	6,000	By Loss transferred to Capital A/cs:	
		Atul	2,400
		Bhaskar	3,600
	6,000		6,000

Note: The syllabus prescribes preparation of Profit and Loss Appropriation Account and not Profit and Loss Account. Also the question prescribed to prepare Profit and Loss Appropriation Account. Net Profit may be determined by preparing a Working Note or may be determined as above.

Opening Capital: Interest on capital is allowed on Opening Capital of the partner. If a partner has neither introduced additional capital nor withdrawn it during the year, closing balance of the Capital Account of the previous year is the *opening balance in the Capital Account* of the Current Year. In case opening capital is not given, it needs to be determined to calculate interest on capital. It is determined by adding the items which have already been deducted (*e.g.*, Share of Loss, Drawings, Interest on Drawings) and by deducting the items which have already been added to the capital (*e.g.*, Additional Capital, Interest on Capital, Profit already credited). It is calculated as follows:

(a) *When Capitals are fixed:*

CALCULATION OF OPENING CAPITAL

	₹
Capital at the end of the year	...
Add: Withdrawal of Capital	...
	...
Less: Additional Capital introduced during the year	...
Capital in the beginning of the year	...

(b) *When Capitals are fluctuating:*

CALCULATION OF OPENING CAPITAL

		₹
Capital at the end of the year		...
Add: Drawings Against Capital (Withdrawal of Capital)		...
Drawings Against Profit		...
Interest on Drawings		...
Share of Loss for the year*		...
		...
Less: Additional Capital introduced during the year	...	
Partner's Salary/Remuneration	...	
Interest on Capital	...	
Share of Profit for the year*	...	...
Capital in the beginning of the year		...

*Either loss or profit will appear at a time.

Alternatively, Opening Capital can be calculated as Balancing Figure by preparing Capital Account of each partner as follows:

Dr. PARTNER'S CAPITAL ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Cash/Bank A/c (Drawings Against Capital)	...	By Balance *b/d* (Balancing Figure)	...
To Drawings A/c (Drawings Against Profit)	...	By Cash/Bank A/c (Capital Introduced)	...
To Interest on Drawings A/c	...	By Interest on Capital A/c	...
To Profit and Loss Appropriation A/c (Loss for the year)	...	By Partner's Salary/Commission A/c	...
To Balance *c/d* (Given)	...	By Profit and Loss Appropriation A/c (Share of Profit)	...
	...		...

Illustration 18 (*Calculation of Opening Capital*).

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

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

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

(c) Interest on capital credited to the Capital Accounts of *A* and *B* were ₹ 15,000 and ₹ 10,000 respectively.

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

(e) Share of profit credited to Capital Accounts was ₹ 1,00,000 each.

Solution: CALCULATION OF OPENING CAPITAL

Particulars		*A* (₹)		*B* (₹)
Capitals at the end		7,00,000		6,00,000
Add: Drawings during the year		75,000		50,000
Interest on Drawings		7,500		5,000
		7,82,500		6,55,000
Less: Capital Introduced during the year	...		1,00,000	
Interest on Capital	15,000		10,000	
Share of Profit for the year	1,00,000	1,15,000	1,00,000	2,10,000
Capitals in the beginning		6,67,500		4,45,000

Alternatively, Capital Account of each partner may be prepared as follows:

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*A* (₹)	*B* (₹)	Particulars	*A* (₹)	*B* (₹)
To Drawings A/c	75,000	50,000	By Balance *b/d* (Balancing Figure)	6,67,500	4,45,000
To Interest on Drawings A/c	7,500	5,000	By Cash/Bank A/c (Addl. Capital Introduced)	...	1,00,000
To Balance *c/d* (Given)	7,00,000	6,00,000	By Interest on Capital A/c	15,000	10,000
			By Profit and Loss Approp. A/c (Share of Profit)	1,00,000	1,00,000
	7,82,500	6,55,000		7,82,500	6,55,000

Illustration 19 (*Calculation of Opening Capital*).

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

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

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

(c) Interest on capital credited to the Capital Accounts of *A* and *B* were ₹ 15,000 and ₹ 10,000 respectively.

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

(e) Share of loss debited to Capital Account of each Partner was ₹ 20,000.

Solution: CALCULATION OF OPENING CAPITAL

Particulars		*A* (₹)		*B* (₹)
Capitals at the end		7,00,000		6,00,000
Add: Drawings during the year		75,000		50,000
Interest on Drawings		7,500		5,000
Share of Loss for the year		20,000		20,000
		8,02,500		6,75,000
Less: Capital Introduced during the year	...		1,00,000	
Interest on Capital	15,000	15,000	10,000	1,10,000
Capitals in the beginning		7,87,500		5,65,000

Illustration 20 (*Calculation of Interest on Capital*).

A and *B* started business on 1st April, 2019 with capitals of ₹ 6,00,000 and ₹ 4,00,000 respectively. During the year, *A* introduced ₹ 1,00,000 as additional capital on 1st October, 2019. They withdrew ₹ 50,000 per month against profits. Interest on capital is to be allowed @ 10% per annum. Calculate interest payable to *A* and *B* for the year ended 31st March, 2020.

Solution: *Interest on A's Capital:*

		₹
Interest on ₹ 6,00,000 for one year:	₹ 6,00,000 × 10/100	60,000
Interest on ₹ 1,00,000 for 6 months:	₹ 1,00,000 × 6/12 × 10/100	5,000
(from 1st October, 2019 to 31st March, 2020)		
		65,000

Interest on B's Capital:

Interest on ₹ 4,00,000 for one year:	₹ 4,00,000 × 10/100	₹ 40,000

Illustration 21.

Ramesh and Naresh are partners in a firm. Their capitals as on 1st April, 2019 were ₹ 2,50,000 and ₹ 1,50,000 respectively. They share profits equally. On 1st July, 2019, they decided that their capitals should be ₹ 2,00,000 each. The necessary adjustment in the capitals were made by introducing or withdrawing capital. Interest on capital is allowed @ 8% p.a. Compute interest on capital for both the partners for the year ended 31st March, 2020.

Solution: Calculation of interest on capital:

	₹
(i) *Interest on Ramesh's Capital:*	
From 1st April, 2019 to 30th June, 2019 (₹ 2,50,000 × 8/100 × 3/12)	5,000
From 1st July, 2019 to 31st March, 2020 (₹ 2,00,000 × 8/100 × 9/12)	12,000
	17,000
(ii) *Interest on Naresh's Capital:*	
From 1st April, 2019 to 30th June, 2019 (₹ 1,50,000 × 8/100 × 3/12)	3,000
From 1st July, 2019 to 31st March, 2020 (₹ 2,00,000 × 8/100 × 9/12)	12,000
	15,000

Illustration 22.

From the following Balance Sheet of *X* and *Y*, calculate interest on capital @ 5% p.a. for the year ended 31st March, 2020:

BALANCE SHEET *as at 31st March, 2020*

Liabilities	₹	Assets	₹
X's Capital A/c	90,000	Sundry Assets	2,10,000
Y's Capital A/c	80,000		
General Reserve	40,000		
	2,10,000		2,10,000

During the year ended 31st March, 2020, *X*'s drawings were ₹ 10,000 and *Y*'s drawings were ₹ 30,000. Profit for the year ended 31st March, 2020 was ₹ 60,000, out of which ₹ 40,000 is transferred to General Reserve.

Solution:

Calculation of Interest on X's Capital:	₹
X's Capital as at 31st March, 2020	90,000
Add: Drawings during the year	10,000
	1,00,000
Less: Profit (added or credited) [1/2 (₹ 60,000 – ₹ 40,000)]	10,000
Capital as at 1st April, 2019	90,000

Interest on capital @ 5% p.a. = ₹ 90,000 × 5/100 = ₹ 4,500.

Calculation of Interest on Y's Capital:	₹
Y's Capital as at 31st March, 2020	80,000
Add: Drawings during the year	30,000
	1,10,000
Less: Profit (added or credited) [1/2 (₹ 60,000 – ₹ 40,000)]	10,000
Capital as at 1st April, 2019	1,00,000

Interest on Capital @ 5% p.a. = ₹ 1,00,000 × 5/100 = ₹ 5,000.

Notes:
1. Capital in the beginning is calculated by adding drawings and deducting profit distributed.
2. Profit during the year was ₹ 60,000 out of which ₹ 40,000 is transferred to Reserve and is shown in the Balance Sheet. Thus, in effect, only ₹ 20,000 were distributed which have been deducted.
3. In the absence of any profit-sharing ratio being given, partners will share profit and loss equally.

Illustration 23 (*Calculation of Interest on Capital, Drawings Against Profits and Drawings Against Capital*).

X and *Y* are partners sharing profits in the ratio of 3 : 2. On 31st March, 2020 after closing the books of account, their capitals are ₹ 10,00,000 and ₹ 12,50,000 respectively. On 1st May, 2019, *X* had introduced an additional capital of ₹ 2,50,000 and *Y* withdrew ₹ 1,25,000 from his capital. On 1st October, 2019, *X* withdrew ₹ 5,00,000 from his capital and *Y* introduced ₹ 6,25,000. After closing the accounts, it was noticed that Interest on Capital @ 6% p.a. has been omitted. During the year ended 31st March, 2020, *X*'s drawings and *Y*'s drawings were ₹ 2,50,000 and ₹ 1,25,000. Profits (before interest on Capital) during the year were ₹ 5,00,000.

Calculate Interest on Capital if the capitals are (a) fixed and (b) fluctuating.

Solution:

(a) *When Capitals are Fixed:*

CALCULATION OF OPENING CAPITAL

Particulars	*X* ₹	*Y* ₹
Closing Capital	10,00,000	12,50,000
Add: Withdrawal of Capital	5,00,000	1,25,000
	15,00,000	13,75,000
Less: Additional Capital Introduced	2,50,000	6,25,000
Opening Capital	12,50,000	7,50,000

CALCULATION OF INTEREST ON CAPITAL

X	₹	*Y*	₹
Interest on Opening Capital (₹ 12,50,000 × 6/100)	75,000	Interest on Opening Capital (₹ 7,50,000 × 6/100)	45,000
Add: Interest on Additional Capital (₹ 2,50,000 × 6/100 × 11/12)	13,750	*Add:* Interest on Additional Capital (₹ 6,25,000 × 6/12 × 6/100)	18,750
	88,750		63,750
Less: Interest on Capital Withdrawn (₹ 5,00,000 × 6/100 × 6/12)	15,000	*Less:* Interest on Capital Withdrawn (₹ 1,25,000 × 11/12 × 6/100)	6,875
	73,750		56,875

(b) *When Capitals are Fluctuating:*

CALCULATION OF OPENING CAPITAL

Particulars	*X* ₹	*Y* ₹
Closing Capital	10,00,000	12,50,000
Add: Withdrawal of Capital	5,00,000	1,25,000
Drawings	2,50,000	1,25,000
	17,50,000	15,00,000
Less: Additional Capital Introduced	2,50,000	6,25,000
	15,00,000	8,75,000
Less: Share of Profit	3,00,000	2,00,000
Opening Capital	12,00,000	6,75,000

CALCULATION OF INTEREST ON CAPITAL

X	₹	*Y*	₹
Interest on Opening Capital (₹ 12,00,000 × 6/100)	72,000	Interest on Opening Capital (₹ 6,75,000 × 6/100)	40,500
Add: Interest on Additional Capital (₹ 2,50,000 × 6/100 × 11/12)	13,750	*Add:* Interest on Additional Capital (₹ 6,25,000 × 6/100 × 6/12)	18,750
	85,750		59,250
Less: Interest on Capital Withdrawn (₹ 5,00,000 × 6/100 × 6/12)	15,000	*Less:* Interest on Capital Withdrawn (₹ 1,25,000 × 6/100 × 11/12)	6,875
	70,750		52,375

Illustration 24 (*Transfer of Net Profit to General Reserve*).

X and *Y* are partners sharing profits and losses in the ratio of 7 : 3. Their Capital Accounts as at 1st April, 2019 stood at *X*—₹ 5,00,000; *Y*—₹ 4,00,000. Partners are allowed interest on capital @ 5% p.a. Drawings of the partners during the year ended 31st March, 2020 were ₹ 72,000 and ₹ 50,000 respectively. Profit for the year before allowing interest on capital and salary to *Y* @ ₹ 5,000 per month was ₹ 8,00,000. 10% of the net profit is to be set aside as General Reserve.

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

Solution:

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

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Net Profit)	8,00,000
X's Current A/c	25,000			
Y's Current A/c	20,000	45,000		
To *Y*'s Salary A/c (*Y*'s Current A/c)		60,000		
To General Reserve A/c (10% of ₹ 8,00,000)		80,000		
To Profit transferred to:				
X's Current A/c (7/10)	4,30,500			
Y's Current A/c (3/10)	1,84,500	6,15,000		
		8,00,000		8,00,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Date	Particulars	*X* ₹	*Y* ₹	Date	Particulars	*X* ₹	*Y* ₹
2020 March 31	To Balance *c/d*	5,00,000	4,00,000	2019 April 1	By Balance *b/d*	5,00,000	4,00,000

Dr. PARTNERS' CURRENT ACCOUNTS *Cr.*

Date	Particulars	*X* ₹	*Y* ₹	Date	Particulars	*X* ₹	*Y* ₹
2020 March 31	To Drawings A/c	72,000	50,000	2020 March 31	By Interest on Capital A/c	25,000	20,000
March 31	To Balance *c/d*	3,83,500	2,14,500	March 31	By *Y*'s Salary A/c	...	60,000
				March 31	By Profit and Loss Appropriation A/c (Profit)	4,30,500	1,84,500
		4,55,500	2,64,500			4,55,500	2,64,500

Illustration 25 (*Transfer of Divisible Profit to General Reserve*).

X and *Y* are partners sharing profits and losses in the ratio of 7 : 3. Their Capital Accounts as at 1st April, 2019 stood at *X*—₹ 5,00,000; *Y*—₹ 4,00,000. Partners are allowed interest on capital @ 5% p.a. Drawings of *X* and *Y* during the year ended 31st March, 2020 were ₹ 72,000 and ₹ 50,000 respectively. Profit for the year before allowing interest on capital and salary to *Y* @ ₹ 5,000 per month was ₹ 8,00,000. 10% of the divisible profit is to be set aside as General Reserve.

Prepare Profit and Loss Appropriation Account.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2020

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Interest on Capital A/cs:			By Profit and Loss A/c	8,00,000
X	25,000		(Net Profit)	
Y	20,000	45,000		
To Y's Salary A/c (*Y*'s Current A/c)		60,000		
To General Reserve A/c*		69,500		
To Profit transferred to:				
X's Current A/c	4,37,850			
Y's Current A/c	1,87,650	6,25,500		
		8,00,000		8,00,000

*Amount transferred to General Reserve = 10% of Divisible Profit
= 10% of ₹ 6,95,000 (*i.e.*, ₹ 8,00,000 – ₹ 25,000 – ₹ 20,000 – ₹ 60,000)
= ₹ 69,500.

4. INTEREST ON PARTNERS' DRAWINGS

Drawings mean the amount withdrawn, in cash or in kind, by partners for their personal use. Drawings may be out of capital or against profit. Both are discussed below:

Drawings against Capital

Drawings against capital is withdrawal of amount out of his or her capital in the firm. Drawings against capital is debited to his or her Capital Account. It means that the capital is reduced by the amount withdrawn.

Interest on capital is allowed on capital for the period it is used in business. As a result of drawings against capital, interest on capital is not allowed to a partner on withdrawn amount.

For example, Anmol (partner) has capital of ₹ 5,00,000 on 1st April, 2019. He withdraws ₹ 1,00,000 on 1st October, 2019 out of his capital. If the Partnership Deed allows interest on capital @ 10% p.a., Anmol will get interest of ₹ 45,000 on capital for the year ended 31st March, 2020, calculated as follows:

On ₹ 5,00,000 @ 10 p.a. for 6 months (1st April, 2019 to 30th September, 2019)	₹ 25,000
On ₹ 4,00,000 (*i.e.*, ₹ 5,00,000 – ₹ 1,00,000) @ 10% p.a. for 6 months (1st October, 2019 to 31st March, 2020)	₹ 20,000
Total Interest	₹ 45,000

Drawings against Profit

Drawings against profit means drawings by a partner against his or her expected share of profit for the year. Drawings against profit is debited to Drawings Account and *not* to the Capital Account of the partner. Actual share of profit of a partner is known at the end of the year and is the date when it becomes due to the partner. Since, withdrawal is earlier than it is due, the firm charges interest for the period amount is withdrawn by the partner.

Difference between Drawings Against Capital and Drawings Against Profit

Basis	*Drawings Against Capital*	*Drawings Against Profit*
1. **Where Debited**	It is debited to Capital Account.	It is debited to Drawings Account.
2. **Part**	It is against capital.	It is against expected profit.
3. **Effect**	It reduces capital.	It does not reduce capital.
4. **Interest on Drawings**	It is not considered for calculating interest on drawings.	It is considered for calculating interest on drawings.
5. **Interest on Capital**	It is considered for calculating interest on capital.	It is not considered for calculating interest on capital.

Interest is charged on drawings against expected profit if the Partnership Deed provides for charging interest on drawings. Interest charged on drawings is transferred to Profit and Loss Appropriation Account and debited to Partners' Capital Accounts (in case of Fluctuating Capital Accounts Method) or Partners' Current Accounts (in case of Fixed Capital Accounts Method). Journal entries passed for interest on drawings are:

Partner's Capital/Current A/c ...Dr.
    To Interest on Drawings A/c
(Interest charged on drawings)

Interest on Drawings A/c ...Dr.
    To Profit and Loss Appropriation A/c
(Interest on Drawings transferred)

Illustration 26.

Chhavi and Neha were partners in a firm sharing profits and losses equally. Chhavi withdrew a fixed amount at the beginning of each quarter. Interest on drawings is charged @ 6% p.a. At the end of the year, interest on Chhavi's drawings amounted to ₹ 900.

Pass necessary Journal entry for charging interest on drawings. *(CBSE 2019)*

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Chhavi's Capital/Current* A/c ...Dr. To Interest on Drawings A/c (Interest on drawings charged)		900	900

*In case of Fixed Capitals.

Interest on amount of drawings is charged on the amount of drawings from the date of withdrawal (drawing) till the end of the financial year.

Calculation of Interest on Drawings

Drawings by a partner may be broadly divided into:

(i) *Irregular Drawings:* It means drawings of same amount or different amounts at irregular intervals; and

(ii) *Regular Drawings:* It means drawings of same amount at regular intervals.

Interest on Drawings when drawings are made at irregular period or of different amounts, *Product Method* of calculating interest is followed. And when drawings are made of same amount at regular intervals, interest on drawings is calculated using *Average Period Method*.

The two methods of calculating interest on drawings are:

I. Product Method; and

II. Average Period Method.

Both the methods are discussed below:

I. Product Method: When *unequal amount* is withdrawn at different dates or when there is irregular drawings, interest on drawings is calculated with the help of *Simple Method* or *Product Method*.

Simple Method: Under this method, interest on drawings is calculated for the period the amount is drawn. The interest is calculated with reference to each drawing.

Product Method: Under this method, the amount of drawings is multiplied with the number of months or number of days (as the case is) it is drawn. The product so obtained is totalled and interest is calculated thereon for one month, if the period taken is in months and for one day, if the period taken is in days.

Formula: Interest on Drawings = Total of Product × $\frac{\text{Rate of Interest}}{100} \times \frac{1}{12}$ or $\frac{1}{365}$.

Illustration 27 (*Calculation of Interest on Drawings by Simple Method and Product Method*).

In a partnership, partners are charged interest on drawings @ 15% p.a. During the year ended 31st March, 2020, a partner withdrew as follows:

Date	1st May, 2019	1st August, 2019	30th September, 2019	31st January, 2020	31st March, 2020
Amount (₹)	2,000	5,000	2,000	6,000	2,000

What is the interest chargeable from the partner?

Solution:

(i) *Simple Method*

Date	Amount (₹)	No. of Months up to 31st March, 2020	Interest @ 15% (₹)
1st May, 2019	2,000	11	275 *
1st August, 2019	5,000	8	500
30th September, 2019	2,000	6	150
31st January, 2020	6,000	2	150
31st March, 2020	2,000	0	0
	17,000		1,075

*Interest = ₹ 2,000 × 15/100 × 11/12 = ₹ 275.

(ii) *Product Method*

When drawings are made in unequal amounts at different dates, interest on drawings is calculated by Product Method as follows:

A Date	*B* Amount (₹)	*C* No. of Months up to 31st March, 2020	*D = B × C* Product (₹)
1st May, 2019	2,000	11	22,000
1st August, 2019	5,000	8	40,000
30th September, 2019	2,000	6	12,000
31st January, 2020	6,000	2	12,000
31st March, 2020	2,000	0	0
	17,000		86,000

Interest on ₹ 86,000 @ 15% p.a. for one month is $\frac{₹\ 86,000 \times 15 \times 1}{100 \times 12}$ = ₹ 1,075.

II. Average Period Method: *This method is used when there is regular drawings or when:*

(a) *the amount of drawings is uniform;* and

(b) *the time interval between the two drawings is also uniform.*

The formula for calculating interest on drawings under this method is:

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

$$\text{*Average Period} = \frac{\text{Months Left after First Drawing} + \text{Months Left after Last Drawing}}{2}$$

Let us take **Different situations** for calculating interest on drawings under this method.

Situation 1. If a partner withdraws *fixed amount* in the *beginning of every month*, interest is charged on the whole amount for *6½ months.**

$$\text{Interest on Drawings} = \frac{\text{Total Drawings} \times \text{Rate of Interest}}{100} \times \frac{6½}{12}$$

*This is the average of months = (12 + 11 + 10 + ... + 1) ÷ 12 = 78 ÷ 12 = 6½ Months.

Or

$$\text{Average Period} = \frac{12 \text{ Months} + 1 \text{ Month}}{2} = 6½ \text{ Months.}$$

Situation 2. If a partner withdraws *fixed amount* at the *end of every month*, interest is charged for *5½ months* (*i.e.*, average period) on the total amount.

$$\text{Interest on Drawings} = \frac{\text{Total Drawings} \times \text{Rate of Interest}}{100} \times \frac{5½}{12}$$

$$\text{Average Period} = \frac{11 \text{ Months} + 0 \text{ Month}}{2} = 5½ \text{ Months.}$$

Situation 3. If a partner withdraws *fixed amount* in the *middle of every month*, interest is charged for *6 months* on the total amount.

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

$$\text{Average Period} = \frac{11½ \text{ Months} + ½ \text{ Month}}{2} = 6 \text{ Months.}$$

Illustration 28 (*Interest on Drawings*).

A partner draws ₹ 10,000 per month. Under the Partnership Deed, interest on drawings is to be charged @ 15% p.a. Calculate interest if the drawings are made regularly:

(i) in the beginning of the month,
(ii) in the middle of the month, or
(iii) at the end of the month.

Solution:

Interest in the three situations will be:

(i) Total Drawings in the year = ₹ 1,20,000, Rate of Interest = 15% p.a.

$$\text{Interest on Drawings} = \frac{₹\,1,20,000 \times 15}{100} \times \frac{6\frac{1}{2}^*}{12} = ₹\ 9,750.$$

$$^*\text{Average Period} = \frac{12\text{ Months} + 1\text{ Month}}{2} = 6\tfrac{1}{2}\text{ Months}.$$

(ii) Total Drawings in the year = ₹ 1,20,000, Rate of Interest = 15% p.a.

$$\text{Interest on Drawings} = \frac{₹\,1,20,000 \times 15}{100} \times \frac{6^*}{12} = ₹\ 9,000.$$

$$^*\text{Average Period} = \frac{11\tfrac{1}{2}\text{ Months} + \tfrac{1}{2}\text{ Month}}{2} = 6\text{ Months}.$$

(iii) Total Drawings in the year = ₹ 1,20,000, Rate of Interest = 15% p.a.

$$\text{Interest on Drawings} = \frac{₹\,1,20,000 \times 15}{100} \times \frac{5\frac{1}{2}^*}{12} = ₹\ 8,250.$$

$$^*\text{Average Period} = \frac{11\text{ Months} + 0\text{ Month}}{2} = 5\tfrac{1}{2}\text{ Months}.$$

Situation 4. If fixed amount is withdrawn *in the beginning of each quarter* during the year, interest is charged on the whole amount for a period of 7½ *months.**

$$\text{Interest on Drawings} = \frac{\text{Total Drawings} \times \text{Rate of Interest}}{100} \times \frac{7\frac{1}{2}}{12}$$

$$^*\text{Average Period} = \frac{12\text{ Months} + 3\text{ Months}}{2} = \frac{15\text{ Months}}{2} = 7\tfrac{1}{2}\text{ Months}.$$

Situation 5. If fixed amount is withdrawn in the *middle of each quarter* during the year, interest is charged on the whole amount for a period of 6 *months.**

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

$$^*\text{Average Period} = \frac{10.5\text{ Months} + 1.5\text{ Months}}{2} = \frac{12\text{ Months}}{2} = 6\text{ Months}.$$

Situation 6. If fixed amount is withdrawn at the *end of each quarter* during the year, interest is charged on the whole amount for a period of 4½ *months.**

$$\text{Interest on Drawings} = \frac{\text{Total Drawings} \times \text{Rate of Interest}}{100} \times \frac{4\frac{1}{2}}{12}$$

$$^*\text{Average Period} = \frac{9\text{ Months} + 0\text{ Month}}{2} = \frac{9\text{ Months}}{2} = 4\tfrac{1}{2}\text{ Months}.$$

Illustration 29 (*When there is regular Drawings at Quarterly Intervals*).

Calculate interest on drawings of Siddhant @ 10% p.a. for the year ended 31st March, 2020 in each of the following alternative cases:

Case 1. If he withdrew ₹ 60,000 in the beginning of each quarter.

Case 2. If he withdrew ₹ 60,000 at the end of each quarter.

Case 3. If he withdrew ₹ 90,000 in the middle of each quarter.

Solution:

Total Drawings in Cases 1 and 2 = ₹ 60,000 × 4 = ₹ 2,40,000;

Total Drawings in Case 3 = ₹ 90,000 × 4 = ₹ 3,60,000.

	Case 1	Case 2	Case 3
Average Period	$= \frac{(12 + 3) \text{ Months}}{2} = 7.5$ Months	$= \frac{(9 + 0) \text{ Months}}{2} = 4.5$ Months	$= \frac{(10.5 + 1.5) \text{ Months}}{2} = 6$ Months
Interest on Drawings	= ₹ 2,40,000 $\times \frac{7.5}{12} \times \frac{10}{100}$ = ₹ 15,000	= ₹ 2,40,000 $\times \frac{4.5}{12} \times \frac{10}{100}$ = ₹ 9,000	= ₹ 3,60,000 $\times \frac{6}{12} \times \frac{10}{100}$ = ₹ 18,000

Situation 7. ***If fixed amount is withdrawn during 6 months:***

(i) *In the beginning of each month:*

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate}}{100} \times \frac{3\frac{1}{2}}{12}$$

(ii) *In the middle of each month:*

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate}}{100} \times \frac{3}{12}$$

(iii) *At the end of each month:*

$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Rate}}{100} \times \frac{2\frac{1}{2}}{12}$$

Illustration 30 (*When drawings are made only for last 6 months).*

A, *B* and *C* started a firm on 1st October, 2019 sharing profits equally. *A* drew regularly ₹ 4,000 in the beginning of every month for the six months ended 31st March, 2020. *B* drew regularly ₹ 4,000 at the end of every month for the six months ended 31st March, 2020. *C* drew regularly ₹ 4,000 in the middle of every month for the six months ended 31st March, 2020.

Calculate interest on drawings @ 5% p.a. for the period ended 31st March, 2020.

Solution: Total Drawings of each partner = ₹ 4,000 × 6 = ₹ 24,000.

	Case 1	Case 2	Case 3
Average Period	$= \frac{(6 + 1) \text{ Months}}{2} = 3.5$ Months	$= \frac{(5 + 0) \text{ Months}}{2} = 2.5$ Months	$= \frac{(5.5 + 0.5) \text{ Months}}{2} = 3$ Months
Interest on Drawings	= ₹ 24,000 $\times \frac{5}{100} \times \frac{3.5}{12}$ = ₹ 350	= ₹ 24,000 $\times \frac{5}{100} \times \frac{2.5}{12}$ = ₹ 250	= ₹ 24,000 $\times \frac{5}{100} \times \frac{3}{12}$ = ₹ 300

Situation 8. ***If the date of withdrawal is not given,*** **interest on total drawings for the year is calculated for six months on the average basis.**

Illustration 31.

Calculate interest on drawings of Rakesh @ 10% p.a. for the year ended 31st March, 2020 in each of the following alternative cases:

Case 1. If his drawings during the year were ₹ 30,000.

Case 2. If he withdraws ₹ 2,500 per month during the year.

Solution:

Case 1. Assuming that drawings were made evenly throughout the year, interest on drawings has been calculated for an average period of 6 months.

Interest on Drawings = ₹ 30,000 × 10/100 × 6/12 = ₹ 1,500.

Case 2. Total Drawings = ₹ 2,500 × 12 = ₹ 30,000

Interest on Drawings = ₹ 30,000 × 10/100 × 6/12 = ₹ 1,500.

> **Important Note:** *If the date of drawings is not given and Accounting period is less than 6 months, then the Interest on Total Drawings is calculated for* **half of the accounting period**.

Situation 9. When the rate of interest is given without the word '*per annum*' (p.a.), interest is charged without considering the time factor.

Illustration 32.

Calculate interest on *A*'s drawings @ 10% if he withdrew ₹ 2,50,000 during the year.

Solution: Interest on drawings = ₹ 2,50,000 × 10/100 = ₹ 25,000.

> *Normally, interest is calculated on the basis of time amount is used.*

> **Remember:** Interest on drawings is an income for the firm and hence is credited to Profit and Loss Appropriation Account. On the other hand, interest on drawings is a loss to the partner and is debited to his Capital Account (in case of Fluctuating Capitals) or Current Account (in case of Fixed Capitals).

The Journal entries to record interest on drawings are:

If Partners' Capital Accounts are fixed.	*If Partners' Capital Accounts are fluctuating.*
(i) Partners' Current A/cs ...Dr. To Interest on Drawings A/c (Interest charged on partners' drawings)	(i) Partners' Capital A/cs ...Dr. To Interest on Drawings A/c (Interest charged on partners' drawings)
(ii) Interest on Drawings A/c ...Dr. To Profit and Loss Appropriation A/c (Interest on drawings transferred to Profit and Loss Appropriation A/c)	(ii) Interest on Drawings A/c ...Dr. To Profit and Loss Appropriation A/c (Interest on drawings transferred to Profit and Loss Appropriation A/c)
Alternatively: In place of above two entries, only single entry may be passed as follows: Partners' Current A/cs ...Dr. To Profit and Loss Appropriation A/c (Interest charged on drawings of partners)	**Alternatively:** In place of above two entries, only single entry may be passed as follows: Partners' Capital A/cs ...Dr. To Profit and Loss Appropriation A/c (Interest charged on drawings of partners)

Illustration 33.

Arun and Arora were partners in a firm sharing profits in the ratio of 5 : 3. Their fixed capitals on 1st April, 2010 were: Arun ₹ 60,000 and Arora ₹ 80,000. They agreed to allow interest on capital @ 12% p.a. and to charge on drawings @ 15% p.a. Profit of the firm for the year ended 31st March, 2011 before all above adjustments was ₹ 12,600. Drawings made by Arun were ₹ 2,000 and by Arora ₹ 4,000 during the year. Prepare Profit and Loss Appropriation Account of Arun and Arora. Show your calculations clearly. The interest on capital will be allowed even if the firm incurs a loss. *(CBSE 2012)*

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2011

Dr. *Cr.*

Particulars	₹	Particulars		₹
To Profit and Loss A/c (Net Loss) (WN 1)	4,200	By Interest on Drawings A/c:		
		Arun's Current A/c	150	
		Arora's Current A/c	300	450
		By Net Loss transferred to:		
		Arun's Current A/c	2,344	
		Arora's Current A/c	1,406	3,750
	4,200			4,200

Working Notes:

1\. *Interest on Capitals:*

	Arun	*Arora*
Opening Capital	₹ 60,000	₹ 80,000
Rate of Interest	12% p.a.	12% p.a.
Interest on Capital	₹ 7,200	₹ 9,600

Total Interest on Capital = ₹ 16,800.

Interest on Capital is a charge against profit and is debited to Profit and Loss Account. Thus, the loss of ₹ 4,200 (*i.e.*, ₹ 16,800 – ₹ 12,600) is transferred to Profit and Loss Appropriation Account.

2\. *Interest on Drawings:*

	Arun	*Arora*
Amount of Drawings	₹ 2,000	₹ 4,000
Rate of Interest	15% p.a.	15% p.a.
Interest on Drawings (for 6 Months)	₹ 150	₹ 300

Since the dates of drawings are not given, interest will be charged for average period of 6 months.

Illustration 34.

A, *B*, and *C* are partners in a firm. According to the Partnership Deed, the partners are entitled to draw up to ₹ 7,000 per month. On the first day of every month *A*, *B* and *C* drew ₹ 7,000; ₹ 6,000 and ₹ 5,000 respectively. Interest on capitals and interest on drawings are fixed @ 8% p.a. and 10% p.a. respectively. Profit for the year ended 31st March, 2020 was ₹ 7,55,000 out of which ₹ 2,00,000 are to be transferred to General Reserve. *B* and *C* are to get salary of ₹ 30,000 and ₹ 45,000 p.a. respectively and *A* is to receive commission @ 10% on distributable profits after charging such commission. On 1st April, 2019, balances of their Capital Accounts were ₹ 5,00,000, ₹ 4,00,000 and ₹ 3,50,000 respectively.

Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2020 and Capital Accounts of Partners in the books of the firm.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2020

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To General Reserve A/c		2,00,000	By Profit and Loss A/c (Net Profit)		7,55,000
To Interest on Capital A/cs:			By Interest on Drawings A/cs (WN 1):		
A (₹ 5,00,000 × 8/100)	40,000		*A* (₹ 84,000 × 10/100 × 13/24)	4,550	
B (₹ 4,00,000 × 8/100)	32,000		*B* (₹ 72,000 × 10/100 × 13/24)	3,900	
C (₹ 3,50,000 × 8/100)	28,000	1,00,000	*C* (₹ 60,000 × 10/100 × 13/24)	3,250	11,700
To Partners' Salaries A/cs:					
B	30,000				
C	45,000	75,000			
To *A*'s Commission A/c (WN 2)		35,609			
To Profit transferred to:					
A's Capital A/c	1,18,697				
B's Capital A/c	1,18,697				
C's Capital A/c	1,18,697	3,56,091			
		7,66,700			7,66,700

PARTNERS' CAPITAL ACCOUNTS

Dr. | *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Drawings A/c	84,000	72,000	60,000	By Balance *b/d*	5,00,000	4,00,000	3,50,000
To Interest on Drawings A/c	4,550	3,900	3,250	By Interest on Capital A/c	40,000	32,000	28,000
To Balance *c/d*	6,05,756	5,04,797	4,78,447	By Partners' Salaries A/c	...	30,000	45,000
				By *A*'s Commission A/c	35,609	...	...
				By Profit and Loss Appropriation A/c	1,18,697	1,18,697	1,18,697
	6,94,306	5,80,697	5,41,697		6,94,306	5,80,697	5,41,697

Working Notes:

1. When partners withdraw uniform amount in the beginning of every month, interest is charged on the total amount of drawings at an agreed rate for 6½ months.
2. *A*'s Commission = 10/110 × (₹ 7,55,000 + ₹ 11,700 – ₹ 2,00,000 – ₹ 1,00,000 – ₹ 75,000) = ₹ 35,609.
3. Unless otherwise stated in the Deed, profit of the year is divided equally among partners.

Illustration 35.

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

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

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

(ii) Interest on drawings is to be charged @ 6% p.a. Each partner withdrew ₹ 4,000 at the end of each quarter commencing from 30th June, 2019.

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

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

(v) Noble is to get rent of ₹ 2,000 per month for use of his building by the firm. It is paid to him by cheque at the end of every month.

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

Profit of the firm for the year ended 31st March, 2020 (before the above adjustments) was ₹ 1,35,000.

Prepare Profit and Loss Appropriation Account and Capital Accounts of Partners if capitals are fixed.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2020

Dr. *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c (Net Profit)		1,10,700
Precious	3,600		[₹ 1,35,000 – ₹ 24,000 (rent) –		
Noble	3,000		₹ 300 (Interest on Loan)]		
Perfect	1,800	8,400	By Interest on Drawings A/cs (Note):		
To Partner's Salaries A/c:			Precious	360	
Precious	2,400		Noble	360	
Noble	3,600	6,000	Perfect	360	1,080
To Profit* transferred to Current A/cs:					
Precious	49,127				
Noble	29,127				
Perfect	19,126	97,380			
		1,11,780			1,11,780

**Appropriation of Divisible Profit:*

	Precious (₹)	Noble (₹)	Perfect (₹)
Profit of ₹ 70,000 in the ratio of 4 : 2 : 1	40,000	20,000	10,000
Balance Profit ₹ 27,380 in the ratio of 1 : 1 : 1	9,127	9,127	9,126
	49,127	29,127	19,126

PARTNERS' CAPITAL ACCOUNTS

Dr. *Cr.*

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

PARTNERS' CURRENT ACCOUNTS

Dr. *Cr.*

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

Notes:

1. When fixed amount is withdrawn *at the end of each quarter* during the year, interest will be charged on the whole amount for average period of 4½ months. Thus, interest on drawings to be charged from each partner will be:

$$\frac{\text{Total Drawings} \times \text{Rate of Interest}}{100} \times \frac{4\frac{1}{2}}{12} = ₹\ 16{,}000 \times 9/2 \times 1/12 \times 6/100 = ₹\ 360.$$

2. Interest on Loan from Perfect and rent payable to Noble are charges against profit.

At the time of calculating interest on drawings, remember the following:

1. When a partner withdraws fixed amount in the beginning of every month, interest is charged on the total amount of drawings for 6½ months at an agreed rate per annum.
2. When a partner withdraws fixed sum in the middle of every month, interest is charged on the total amount of drawings for 6 months at an agreed rate per annum.
3. When a partner withdraws fixed sum at the end of every month, interest is charged on the total amount of drawings for 5½ months at an agreed rate per annum.
4. When a partner withdraws fixed sum in the beginning of each quarter, interest is charged on the total amount of drawings for a period of 7½ months at an agreed rate per annum.
5. When a partner withdraws fixed sum in the middle of each quarter, interest is charged on the total amount of drawings for a period of 6 months at an agreed rate per annum.
6. When a partner withdraws fixed sum at the end of each quarter, interest is charged on the total amount of drawings for a period of 4½ months at an agreed rate per annum.
7. When a partner withdraws unequal amount on different dates, interest is calculated using *Simple Method* or *Product Method*.
8. When dates of drawings are given and the interest is to be charged at an agreed rate per annum, interest is calculated on the basis of time.
9. If date of withdrawal is not given, the interest on total drawings for the year is calculated for six months on the average basis.
10. When rate of interest is given without the word 'per annum', interest is charged without considering the time factor.

5. PAST ADJUSTMENTS (ADJUSTMENTS FOR INCORRECT APPROPRIATIONS OF PROFITS IN PAST) AFTER CLOSING THE BOOKS

Sometimes after closing the accounts of a partnership firm, *i.e.*, preparing the financial statements, some errors or omissions in the accounts of the earlier years are noticed. For example, interest on capital or drawings is omitted, allowed or charged at higher or lower rate, profits or losses are distributed among the partners in a wrong ratio and so on. These errors and omissions are rectified by adjusting the Capital Accounts of the affected partners by passing (a) an adjustment entry, or (b) adjustment entries.

(A) When an Adjustment Entry (Single Adjustment Entry) is passed: In this case, net effect of the errors is determined and an adjustment entry is passed by debiting and crediting the Partners' Capital/Current Accounts.

Let us take an example to understand it better. Following is the Profit and Loss Appropriation Account of a firm in which *A*, *B* and *C* are equal partners:

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

Particulars		₹	Particulars	₹
To Profit transferred to:			By Profit and Loss A/c—Net Profit	3,00,000
A's Capital A/c	1,00,000			
B's Capital A/c	1,00,000			
C's Capital A/c	1,00,000	3,00,000		
		3,00,000		3,00,000

After preparing the financial statements, it was noticed that interest on capital was not allowed to *A*—₹ 12,000, *B* —₹ 9,600 and *C*—₹ 10,500 and also interest was not charged on drawings of *A* and *B* amounting to ₹ 1,200 and ₹ 900 respectively.

Correct Profit and Loss Appropriation Account giving effect to the above omissions would have been as follows:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2020

Dr. | *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c—Net Profit		3,00,000
A	12,000		By Interest on Drawings A/cs:		
B	9,600		*A*	1,200	
C	10,500	32,100	*B*	900	2,100
To Profit transferred to:					
A's Capital A/c	90,000				
B's Capital A/c	90,000				
C's Capital A/c	90,000	2,70,000			
		3,02,100			3,02,100

From the corrected Profit and Loss Appropriation Account, following is observed:

	A's Capital A/c	*B*'s Capital A/c	*C*'s Capital A/c
I. Credited Short for Interest on Capitals	₹ 12,000	₹ 9,600	₹ 10,500
II. Debited Short for Interest on Drawings	(₹ 1,200)	(₹ 900)	—
III. Credited Excess as Share of Profit [₹ 32,100 (Interest on Capital) – ₹ 2,100 (Interest on Drawings) Equally]	(₹ 10,000)	(₹ 10,000)	(₹ 10,000)
Net Effect	₹ 800 Short Credited	(₹ 1,300) Excess Credited	₹ 500 Short Credited

An adjustment entry rectifying the above errors can be passed as follows:

Date	Particulars		L.F.	Dr. ₹	Cr. ₹
2020 March 31	*B*'s Capital A/c	...Dr.		1,300	
	To *A*'s Capital A/c				800
	To *C*'s Capital A/c				500
	(Interest on capital not allowed and Interest on drawings not charged, now adjusted)				

Alternatively, a table can be prepared by following the below specified procedure for determining the net effect of the past adjustments and passing the adjustment entry:

Step 1: Prepare an analytical table with one column for particulars, one for each partner separately and one for the firm. The columns for the partners and the firm are divided into two parts—debit and credit. An outlay of the Analytical Table is as follows:

Particulars	*A*'s Capital/Current* A/c		*B*'s Capital/Current* A/c		*C*'s Capital/Current* A/c		Firm (Profit and Loss Adjustment Account)	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
Interest on Capital		...		...		...	...	
Interest on Drawings	...		...		...			...

*In case of fixed capitals.

Step 2: Calculate interest on capital earlier omitted. Place interest due to individual Partners in their respective credit columns and total interest so omitted in the debit column of the firm (as it is an expense for the firm).

Step 3: Calculate interest on drawings earlier omitted to be considered. Place interest due from individual partners in their respective debit columns and total interest so omitted in the credit column of the firm (as it is an income for the firm).

Step 4: Repeat the process for any other expense or income omitted.

Step 5: Find out balance of the columns designed for the firm. This will disclose net profit or net loss.

Step 6: Divide profit or loss (as per **Step 5** above) among the partners in their profit-sharing ratio.

Step 7: Find the balance of each partner separately. In case one partner has debit balance, the other partner must have credit balance of the same amount.

Step 8: Pass Adjustment Journal entry with the amounts determined as per **Step 7**.

Note: If adjustments are to be made for more than one year, then ascertain the consolidated position and then pass the required Journal entry.

Illustration 36.

P and *Q* were partners in a firm sharing profits equally. Their fixed capitals were ₹ 1,00,000 and ₹ 50,000 respectively. The Partnership Deed provided for Interest on Capital at the rate of 10% per annum. For the year ended 31st March, 2016, the profits of the firm were distributed without providing Interest on Capital.

Pass necessary adjustment entry to rectify the error. *(Delhi 2017)*

Solution:

ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2016 March 31	*Q*'s Current A/c ...Dr.		2,500	
	To *P*'s Current A/c			2,500
	(Adjustment of omission of Interest on Capital)			

Working Notes:

1. *Calculation of Interest on Capital:*

   P = ₹ 1,00,000 × 10/100 = ₹ 10,000; *Q* = ₹ 50,000 × 10/100 = ₹ 5,000.

   Total Interest on Capital = ₹ 10,000 + ₹ 5,000 = ₹ 15,000.

   The above interest on capital has not been credited to the partners. It is to be credited to the Partners' Current Accounts resulting in a loss of ₹ 15,000 to the firm, which is to be debited to the partners in their profit-sharing ratio, *i.e.*, equally.

2. *Statement Showing the Adjustment for Interest on Capital and its effect:*

Particulars	*P*'s Current A/c		*Q*'s Current A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
I. Interest on Capital (WN 1)	...	10,000	...	5,000	15,000	...
II. For Sharing the above loss (Equally)	7,500	...	7,500	...	...	15,000
	7,500	10,000	7,500	5,000	15,000	15,000
Balance to be adjusted (Net effect)	2,500 (Cr.)		2,500 (Dr.)		Nil	

Illustration 37.

A and *B* are partners in a firm sharing profits and losses in the ratio of 3 : 2. Following was the Balance Sheet of the firm as at 31st March, 2020:

Liabilities	₹	Assets	₹
Capital A/cs:		Sundry Assets	80,000
A	60,000		
B	20,000		
	80,000		80,000

Profit ₹ 30,000 for the year ended 31st March, 2020 was divided between the partners without allowing interest on capitals @ 12% p.a. and salary to *A* @ ₹ 1,000 per month. During the year, *A* withdrew ₹ 10,000 and *B* ₹ 20,000.

Pass necessary adjustment Journal entry and show your working clearly. *(Delhi 2011, Modified)*

Solution: ADJUSTMENT ENTRY

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2020 March 31	*B*'s Capital A/c	...Dr.		5,280	
	To *A*'s Capital A/c				5,280
	(Interest on capitals and salary to *A* not allowed, now adjusted) (WN)				

Working Notes:

1. *Calculation of Opening Capital:*

Particulars	*A* (₹)	*B* (₹)
Closing Capital	60,000	20,000
Less: Profit already credited (3 : 2)	18,000	12,000
	42,000	8,000
Add: Drawings already debited	10,000	20,000
Capital in the beginning	52,000	28,000

2. TABLE SHOWING ADJUSTMENT TO BE MADE

Particulars	*A*'s Capital A/c		*B*'s Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
I. Interest on Capital	...	6,240	...	3,360	9,600	...
II. Salary to *A*	...	12,000	...	...	12,000	...
III. Loss to be Debited (3 : 2)	12,960	...	8,640	...	...	21,600
	12,960	18,240	8,640	3,360	21,600	21,600
Net Balance (Effect)	5,280 (Cr.)		5,280 (Dr.)		Nil	

Illustration 38 (*Profits Apportioned without Providing for Interest on Capital and Interest on Drawings*).

Mannu and Shristhi are partners in a firm sharing profits in the ratio of 3 : 2. Following is the Balance Sheet of the firm as on 31st March, 2020:

BALANCE SHEET *as at 31st March, 2020*

Liabilities		₹	Assets		₹
Mannu's Capital	30,000		Drawings:		
Shristhi's Capital	10,000	40,000	Mannu	4,000	
			Shristhi	2,000	6,000
			Other Assets		34,000
		40,000			40,000

Profit for the year ended 31st March, 2020 was ₹ 5,000 which was divided in the agreed ratio, but interest @ 5% p.a. on capital and 6% p.a. on drawings was inadvertently omitted. Adjust interest on drawings on an average basis for 6 months. Give the adjustment entry. *(NCERT, Modified Years)*

Solution:

ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020 March 31	Shristhi's Capital A/c ...Dr. To Mannu's Capital A/c (Adjustment entry passed for omission of interest on capital and drawings)		288	288

Working Notes:

1. For the calculation of Interest on Capital, opening capital is calculated.

CALCULATION OF OPENING CAPITAL AND INTEREST THEREON

Particulars	Mannu ₹	Shristhi ₹
Closing Capital	30,000	10,000
Add: Drawings already debited*	...	...
	30,000	10,000
Less: Profit of ₹ 5,000 already credited in 3 : 2	3,000	2,000
Opening Capital	27,000	8,000
Interest on Capital @ 5% per annum	₹ 27,000 × 5/100 = ₹ 1,350	₹ 8,000 × 5/100 = ₹ 400

*For calculating opening capital, drawings are added. However, drawings of Mannu and Shristhi appear in the Balance Sheet. It means that their Capital Accounts have not been adjusted for their drawings. Therefore, their drawings have not been added back.

2. *Calculation of Interest on Drawings:* Dates of drawings are not given. Therefore, interest on drawings will be charged for the average period, *i.e.*, 6 months.

   Interest on Drawings:

   Mannu = ₹ 4,000 × 6/12 × 6/100 = ₹ 120; Shristhi = ₹ 2,000 × 6/12 × 6/100 = ₹ 60.

3. ADJUSTMENT TABLE

Particulars	Mannu's Capital A/c		Shristhi's Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
I. Interest on Capital not yet credited	...	1,350	...	400	1,750	...
II. Interest on Drawings not yet debited	120	...	60	...	...	180
III. Profit after Interest on Capital and Interest on Drawings ₹ 3,430 (*i.e.*, ₹ 5,000 – ₹ 1,750 + ₹ 180) to be credited in the ratio of 3 : 2	...	2,058	...	1,372	3,430	...
IV. Profit of ₹ 5,000 already distributed now taken back (debited)	3,000	...	2,000	...	...	5,000
	3,120	3,408	2,060	1,772	5,180	5,180
Net Effect	288 (Cr.)		288 (Dr.)		Nil	

Illustration 39.

On 31st March, 2014, balances in the Capital Accounts of Eleen, Monu and Ahmad after making adjustments for profits and drawings were ₹ 1,60,000, ₹ 1,20,000 and ₹ 80,000 respectively. Subsequently, it was discovered that the interest on capital and drawings had been omitted.

(i) Profit for the year ended 31st March, 2014 was ₹ 40,000.

(ii) During the year, Eleen and Monu each withdrew a total sum of ₹ 24,000 in equal instalments in the beginning of each month and Ahmad withdrew a total sum of ₹ 48,000 in equal instalments at the end of each month.

(iii) The interest on drawings was to be charged @ 5% p.a. and interest on capital was to be allowed @ 10% p.a.

(iv) The profit-sharing ratio among the partners was 2 : 1 : 1.

Showing your working notes clearly, pass the necessary rectifying entry. *(Delhi 2015 C)*

Solution:

RECTIFYING ENTRY

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2014 March 31	Eleen's Capital A/c	...Dr.		3,850	
	To Monu's Capital A/c				2,950
	To Ahmad's Capital A/c				900
	(Rectifying entry passed for correct profits)				

Working Notes:

1. *Calculation of Opening Capital and Interest thereon:*

Particulars	Eleen (₹)	Monu (₹)	Ahmad (₹)
A. Closing Capital	1,60,000	1,20,000	80,000
B. *Add:* Drawings already Debited	24,000	24,000	48,000
	1,84,000	1,44,000	1,28,000
C. *Less:* Profit already Credited	20,000	10,000	10,000
D. Opening Capital	1,64,000	1,34,000	1,18,000
E. Interest on Capital	₹ 1,64,000 × 10/100 = ₹ 16,400	₹ 1,34,000 × 10/100 = ₹ 13,400	₹ 1,18,000 × 10/100 = ₹ 11,800

Total Interest on Capital = ₹ 16,400 + ₹ 13,400 + ₹ 11,800 = ₹ 41,600.

2. *Interest on Drawings (For Eleen and Monu 6.5 Months and for Ahmad 5.5 Months):*

$$\text{Eleen} = ₹\ 24{,}000 \times \frac{5}{100} \times \frac{13}{24} = ₹\ 650$$

$$\text{Monu} = ₹\ 24{,}000 \times \frac{5}{100} \times \frac{13}{24} = ₹\ 650$$

$$\text{Ahmad} = ₹\ 48{,}000 \times \frac{5}{100} \times \frac{11}{24} = ₹\ 1{,}100$$

$$\text{Total Interest on Drawings} = ₹\ 2{,}400$$

3. STATEMENT SHOWING ADJUSTMENT TO BE MADE

Particulars	Eleen's Capital A/c		Monu's Capital A/c		Ahmad's Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
I. For Interest on Capital	...	16,400	...	13,400	...	11,800	41,600	–
II. For Interest on Drawings	650	...	650	...	1,100	...	...	2,400
III. For Profit to be Shared ₹ 800 (*i.e.*, ₹ 40,000 – ₹ 41,600 + ₹ 2,400) in the ratio of 2 : 1 : 1	...	400	...	200	...	200	800	...
IV. Profit of ₹ 40,000 already distributed in the ratio of 2 : 1 : 1, now reversed	20,000	...	10,000	...	10,000	...	...	40,000
	20,650	16,800	10,650	13,600	11,100	12,000	42,400	42,400
Net Effect	3,850 (Dr.)		2,950 (Cr.)		900 (Cr.)		...	

Illustration 40 (*Omission of Interest on Capital when Fixed Capitals are given*).

X, *Y* and *Z* are partners. They have omitted interest on capital @ 10% p.a. for three years ended 31st March, 2020. Their fixed capitals on which interest was to be calculated throughout were: *X*—₹ 10,000; *Y*—₹ 8,000 and *Z*—₹ 7,000. Their profit-sharing ratios for the years ended 31st March, were: 2018—1 : 2 : 2; 2019—5 : 3 : 2; 2020—4 : 5 : 1. The firm earned profit of ₹ 2,500 in each year. Pass necessary adjustment Journal entry.

Solution: ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020 March 31	*Y*'s Current A/c ...Dr.		600	
	To *X*'s Current A/c			250
	To *Z*'s Current A/c			350
	(Interest on capital omitted to be provided, now adjusted)			

Working Notes:

1. Interest on capital @ 10% p.a: *X*—₹ 1,000; *Y*—₹ 800 and *Z*—₹ 700.

   The above interest on capital ₹ 2,500 (*i.e.,* ₹ 1,000 + ₹ 800 + ₹ 700) has not been credited to the partners. Now, it is to be credited to the Partners' Current Accounts resulting in a loss of ₹ 2,500 to the firm which is to be debited to the partners in their profit-sharing ratio.

2. STATEMENT SHOWING THE ADJUSTMENT TO BE MADE

Particulars	*X* ₹	*Y* ₹	*Z* ₹
I. Amount already credited as Share of Profit:			
for the year ended 31st March, 2018	500	1,000	1,000
for the year ended 31st March, 2019	1,250	750	500
for the year ended 31st March, 2020	1,000	1,250	250
...Dr.	2,750	3,000	1,750
II. Amount which should have been credited as Interest on Capital:			
for the year ended 31st March, 2018	1,000	800	700
for the year ended 31st March, 2019	1,000	800	700
for the year ended 31st March, 2020	1,000	800	700
...Cr.	3,000	2,400	2,100
III. Difference (I – II)	250 (Cr.)	600 (Dr.)	350 (Cr.)

Note: Since capitals of the partners are fixed, adjustment entry will be passed through Partners' Current Accounts.

Illustration 41 (*Interest on Capital Provided at a Higher Rate*).

X, *Y* and *Z* are partners in a firm sharing profits and losses in the ratio of 5 : 3 : 2. Their fixed capitals were ₹ 3,00,000; ₹ 2,00,000 and ₹ 1,00,000 respectively. For the year ended 31st March, 2020, interest on capital was credited to them @ 10% p.a. instead of 8% p.a.

Showing your working notes clearly, pass necessary adjustment Journal entry.

Solution: ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020 April 1	*Y*'s Current A/c ...Dr.		400	
	To *Z*'s Current A/c			400
	(Interest on capital excessive charged, now rectified)			

Working Note:

TABLE SHOWING THE ADJUSTMENT TO BE MADE

Particulars	*X*'s Current A/c		*Y*'s Current A/c		*Z*'s Current A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
I. Interest on Capital wrongly credited @ 10% p.a., now reversed	30,000	...	20,000	...	10,000	...	...	60,000
II. Interest on Capital credited @ 8% p.a.	...	24,000	...	16,000	...	8,000	48,000	...
III. Profit* credited to partners in 5 : 3 : 2	...	6,000	...	3,600	...	2,400	12,000	...
Total	30,000	30,000	20,000	19,600	10,000	10,400	60,000	60,000
Net Balance (Effect)	...		400 Dr.		400 Cr.		...	

*Low rate of interest on capital will increase the profit of the firm by ₹ 12,000 (*i.e.*, ₹ 60,000 – ₹ 48,000) which is divisible among partners.

Illustration 42 (*Rectification of Interest on Capital less Allowed*).

A, *B* and *C* are partners in a firm sharing profits in the ratio of 2 : 2 : 1. Their capitals (fixed) are ₹ 1,00,000; ₹ 80,000 and ₹ 70,000 respectively. For the year ended 31st March, 2020, interest on capital was credited to them @ 9% p.a. instead of 12%. Give the adjustment Journal entry.

Solution:

ADJUSTMENT ENTRY

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2020					
April 1	*B*'s Current A/c	...Dr.		600	
	To *C*'s Current A/c				600
	(Interest less charged on capital, now rectified)				

Working Note:

Interest on capital has been credited @ 9% instead of 12%. So, interest @ 3% should be credited to partners and the total of this should be debited to partners in their profit-sharing ratio because firm's profit is reduced up to that extent.

TABLE SHOWING ADJUSTMENT TO BE MADE

Partners	Amount that should be credited (Cr.)	Amount that should be debited (Dr.)	Net Effect
A	(₹ 1,00,000 × 3/100) = ₹ 3,000	(₹ 7,500 × 2/5) = ₹ 3,000	...
B	(₹ 80,000 × 3/100) = ₹ 2,400	(₹ 7,500 × 2/5) = ₹ 3,000	₹ 600 Dr.
C	(₹ 70,000 × 3/100) = ₹ 2,100	(₹ 7,500 × 1/5) = ₹ 1,500	₹ 600 Cr.
	₹ 7,500	₹ 7,500	

Illustration 43 (*Interest on Capital Wrongly Provided in the Accounts*).

A, *B* and *C* are partners in a firm. Partnership Deed does not provide for interest on capital, still it was credited to Partners' Capital Accounts @ 5% p.a. for the two years ended 31st March, 2019 and 31st March, 2020. Their fixed capitals on which interest was calculated throughout were: *A*—₹ 50,000; *B*—₹ 40,000 and *C*—₹ 30,000.

During the two years ended 31st March, they shared profits as follows:

2019—5 : 3 : 2; and 2020—2 : 2 : 1.

You are required to pass an adjustment entry as at 1st April, 2020.

Solution:

ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020 April 1	*C*'s Current A/c ...Dr.		600	
	To *A*'s Current A/c			400
	To *B*'s Current A/c			200
	(Interest on capital wrongly provided in the accounts for two years, now adjusted)			

Working Note:

STATEMENT SHOWING THE ADJUSTMENT TO BE MADE

Partners	31st March, 2019			31st March, 2020			(c + f)
	(a) Interest on Capital (₹)	(b) Profit ₹	(c = a + b) Adjustment ₹	(d) Interest on Capital (₹)	(e) Profit ₹	(f = d + e) Adjustment ₹	Net Adjustments ₹
A	– 2,500	+ 3,000 (5/10)	+ 500	– 2,500	+ 2,400 (2/5)	– 100	+ 400 (Cr.)
B	– 2,000	+ 1,800 (3/10)	– 200	– 2,000	+ 2,400 (2/5)	+ 400	+ 200 (Cr.)
C	– 1,500	+ 1,200 (2/10)	– 300	– 1,500	+ 1,200 (1/5)	– 300	– 600 (Dr.)
	– 6,000	6,000	...	– 6,000	6,000	...	...

Note: Since interest on capital was allowed, profit decreased by the total amount of interest. Interest allowed was taken by the partners in their profit-sharing ratio. Therefore, interest on capital should be written back and profit (*i.e.*, total amount of interest) should be credited to partners in their profit-sharing ratio.

Illustration 44.

A, *B* and *C* were partners in a firm. On 1st April, 2018, their capitals stood at ₹ 4,00,000, ₹ 3,00,000 and ₹ 2,00,000 respectively. As per the provisions of the Partnership Deed:

(i) *A* was entitled to a salary of ₹ 5,000 per month.

(ii) Partners were entitled to interest on capital @ 10% p.a.

The net profit for the year ended 31st March, 2019, ₹ 3,00,000 was divided among the partners without providing for the above items. Showing your working clearly, pass an adjustment entry to rectify the above error. (*CBSE 2019 C*)

Solution:

ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2019 March 31	*B*'s Capital A/c ...Dr.		20,000	
	C's Capital A/c ...Dr.		30,000	
	To *A*'s Capital A/c			50,000
	(Omission of interest on capital and salary, now rectified)			

Working Note:

TABLE SHOWING THE ADJUSTMENT TO BE MADE

Particulars	*A*'s Capital A/c		*B*'s Capital A/c		*C*'s Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
1. Profit already distributed, now taken back (1 : 1 : 1)	1,00,000	...	1,00,000	...	1,00,000	...	...	3,00,000
2. Profit as should be distributed:								
—Salary	...	60,000	...	...	...	...	60,000	...
—Interest on Capital	...	40,000	...	30,000	...	20,000	90,000	...
—Profit of ₹ 1,50,000 (*i.e.*, ₹ 3,00,000 – ₹ 60,000 – ₹ 90,000) in 1 : 1 : 1	...	50,000	...	50,000	...	50,000	1,50,000	...
	1,00,000	1,50,000	1,00,000	80,000	1,00,000	70,000	3,00,000	3,00,000
3. Net Effect (Dr./Cr.)	50,000 (Cr.)		20,000 (Dr.)		30,000 (Dr.)		...	

Illustration 45 (*Interest on Capitals and Salary/Commission not Allowed to Partners, Profit Distributed in Wrong Ratio*).

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

Pass necessary adjustment entry showing the workings clearly. *(Delhi 2010)*

Solution:

ADJUSTMENT ENTRY

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	A's Current A/c ...Dr.		3,675	
	To *B*'s Current A/c			930
	To *C*'s Current A/c			2,745
	(Adjustment entry passed for wrong appropriation)			

Working Notes:

1. It is presumed that capitals of the partners are fixed. As a result, interest on capitals has been calculated on given balances of capitals.

	₹
2. Net Profit	30,000
Less: Interest on Capital (₹ 1,500 + ₹ 1,000 + ₹ 500)	3,000
Profit after Charging Interest on Capital	27,000

C's Commission = 5/100 × ₹ 27,000 = ₹ 1,350.

3. TABLE SHOWING ADJUSTMENT TO BE MADE

Particulars		*A* ₹	*B* ₹	*C* ₹
I. Profit wrongly credited, now reversed	(Dr.)	15,000	10,000	5,000
II. *Amount which should have been credited:*				
Interest on Capital		1,500	1,000	500
Salary		...	6,000	...
Commission (WN 2)		...	...	1,350
Net Divisible Profit* Distributed (5 : 2 : 3)		9,825	3,930	5,895
	(Cr.)	11,325	10,930	7,745
III. Net Effect (I – II)		3,675 (Dr.)	930 (Cr.)	2,745 (Cr.)

*Divisible Profit = ₹ 30,000 – ₹ 3,000 (interest on capitals) – ₹ 6,000 (*B*'s Salary) – ₹ 1,350 (*C*'s Commission) = ₹ 19,650.

Illustration 46 (*Interest on Capitals Allowed at Lower Rate When the Capitals are Fluctuating and Distribution of Profit in Wrong Ratio*).

The capitals of *X*, *Y* and *Z* as on 31st March, 2020 amounted to ₹ 1,50,000, ₹ 5,50,000 and ₹ 11,00,000 respectively. Divisible profit amounting to ₹ 3,00,000 for the year ended 31st March, 2020 was distributed in the ratio of 4 : 1 : 1 after allowing interest on capital @ 10% p.a. During the year, each partner withdrew ₹ 50,000 per month in the beginning of each month. The Partnership Deed was silent as to profit-sharing ratio and interest on drawings but provided for interest on capital @ 12% p.a.

Showing your workings, pass the necessary adjustment entry to rectify the above error.

Solution:

ADJUSTMENT ENTRY

Date	Particulars		L.F.	Dr. (₹)	Cr. (₹)
2020 March 31	*X*'s Capital A/c	...Dr.		1,10,000	
	To *Y*'s Capital A/c				50,000
	To *Z*'s Capital A/c				60,000
	(Interest on capital allowed at lower rate and profits distributed in wrong ratio, now rectified)				

Working Notes:

1. *Calculation of Interest on Capital already provided and Opening Capital:*

Particulars	*X* (₹)	*Y* (₹)	*Z* (₹)
A. Closing Capital	1,50,000	5,50,000	11,00,000
B. *Add:* Drawings already debited (₹ 50,000 × 12)	6,00,000	6,00,000	6,00,000
	7,50,000	11,50,000	17,00,000
C. *Less:* Profit already credited (4 : 1 : 1)	2,00,000	50,000	50,000
D. Opening Capital *Plus* Interest on Capital	5,50,000	11,00,000	16,50,000
E. *Less:* Interest on Capital (D × 10/110)	50,000	1,00,000	1,50,000
F. Opening Capital (D – E)	5,00,000	10,00,000	15,00,000

2. ADJUSTMENT TABLE

Particulars	*X*'s Capital A/c		*Y*'s Capital A/c		*Z*'s Capital A/c		Firm	
	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)	Dr. (₹)	Cr. (₹)
I. Amount already credited, now taken back:								
• Interest on Capital @ 10% p.a.	50,000	...	1,00,000	...	1,50,000	...	...	3,00,000
• Share of Profit (4 : 1 : 1)	2,00,000	...	50,000	...	50,000	...	...	3,00,000
II. Amount which should have been credited:								
• Interest on Capital @ 12% p.a.	...	60,000	...	1,20,000	...	1,80,000	3,60,000	...
• Share of Profit* Credited to Partners In the ratio of 1 : 1 : 1	...	80,000	...	80,000	...	80,000	2,40,000	...
	2,50,000	1,40,000	1,50,000	2,00,000	2,00,000	2,60,000	6,00,000	6,00,000
III. Net Effect (Dr. – Cr.)	1,10,000 (Dr.)		50,000 (Cr.)		60,000 (Cr.)		Nil	

*₹ 2,40,000 (*i.e.*, ₹ 3,00,000 + ₹ 3,00,000 – ₹ 3,60,000).

(B) When Adjustment Journal Entries (in Place of one Adjustment Entry) are passed: In this situation, analytical table to determine the net effect of all the adjustments is not prepared instead Journal entries are passed for each error or omission by debiting or crediting Profit and Loss Adjustment Account. After passing the entries for adjustment of errors and omissions, Profit and Loss Adjustment Account is closed by debiting or crediting (as the situation is) with the corresponding credit or debit to the Partners' Current Accounts, if Fixed Capital Accounts Method is followed or Partners' Capital Accounts, if Fluctuating Capital Accounts Method is followed.

Accounting Entries

Following Journal entries shall be passed through Profit and Loss Adjustment Account:

(i) *Adjustment entries for the items which are to be credited to the Partners' Capital/Current Accounts*:

Profit and Loss Adjustment A/c ...Dr.
    To Partners' Capital/Current A/cs
(Adjustment made for previously omitted, now recorded)

(ii) *Adjustment entries for the items which are to be debited to the Partners' Capital/Current Accounts*:

Partners' Capital/Current A/cs ...Dr.
    To Profit and Loss Adjustment A/c
(Adjustment made for previously omitted, now recorded)

(iii) *For Net Profit/Loss due to above adjustments:*

(a) **For Profit**

Profit and Loss Adjustment A/c ...Dr.
    To Partners' Capital/Current A/cs
(Profit on adjustment credited to Partners' Capital/Current Accounts)

(b) **For Loss**

Partners' Capital/Current A/cs ...Dr.
    To Profit and Loss Adjustment A/c
(Loss on adjustment transferred to Partners' Capital/Current Accounts)

Note: If capitals of the partners are fixed, adjustment entries are passed through Partners' Current Accounts.

Illustration 47.

P, *Q* and *R* are partners in a firm. Their Capital Accounts stood at ₹ 3,00,000; ₹ 1,50,000 and ₹ 1,50,000 respectively on 1st April, 2020.

As per the provisions of the Deed: (i) *R* was to be allowed a remuneration of ₹ 36,000 per annum, (ii) Interest @ 5% p.a. was to be provided on capitals and (iii) Profits were to be distributed in the ratio of 2 : 2 : 1. Ignoring the above terms, net profit of ₹ 1,80,000 for the year ended 31st March, 2020 was distributed among the three partners equally.

Pass the Journal entries to rectify the above errors.

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020				
April 1	*P*'s Capital A/c ...Dr.		60,000	
	Q's Capital A/c ...Dr.		60,000	
	R's Capital A/c ...Dr.		60,000	
	To Profit and Loss Adjustment A/c			1,80,000
	(Share of profit wrongly credited to partners, now reversed)			
	Profit and Loss Adjustment A/c ...Dr.		36,000	
	To *R*'s Capital A/c			36,000
	(Remuneration credited to *R*'s Capital Account)			
	Profit and Loss Adjustment A/c ...Dr.		30,000	
	To *P*'s Capital A/c			15,000
	To *Q*'s Capital A/c			7,500
	To *R*'s Capital A/c			7,500
	(Interest on capitals @ 5% p.a. credited to Capital Accounts of respective partners)			

	Profit and Loss Adjustment A/c ...Dr.		1,14,000	
	To *P*'s Capital A/c			45,600
	To *Q*'s Capital A/c			45,600
	To *R*'s Capital A/c			22,800
	(Divisible profit credited to Partners' Capital Accounts in the ratio of 2 : 2 : 1)			

6. GUARANTEE OF PROFIT

A new partner (or partners) may be admitted in the firm with minimum guaranteed profit from the business. The profit may be guaranteed to an existing or incoming (new) partner by:

(a) all the remaining partners in an agreed ratio; or

(b) one or more of the existing or old partners.

When the guaranteed partner's or new partner's share of profit is more than the guaranteed amount, his actual share of profit is given to him instead of the guaranteed amount of profit.

(a) **Guarantee of Profit by all the Remaining Partners**

When all the remaining partners (*i.e.*, other than the guaranteed partner), guarantee that the guaranteed partner (or partners) shall be given a minimum amount of profit, following steps are followed:

Step 1: Share of profit as per profit-sharing ratio is determined, and

Step 2: Minimum guaranteed profit is determined.

The higher of the above two amounts (amounts calculated as per **Step 1** and **Step 2**) is given to the guaranteed partner. If the share of profit is less than the guaranteed amount, the difference in the amount of profit, *i.e.*, minimum guaranteed profit *minus* share of profit of the guaranteed partner (called '**deficit**') is borne by the remaining partners in the agreed ratio and where the agreed ratio is not given the deficit is borne by them in their profit-sharing ratio.

Accounting Entries

1. *On Distributing the Profit as if there is no Guarantee Agreement:*

   Profit and Loss Appropriation A/c ...Dr.

   To All Partners' Capital A/cs

2. *On Charging Deficiency to Guaranteeing Partner(s):*

   Guaranteeing Partners' Capital A/cs ...Dr.

   To Guaranteed Partner's Capital A/c

Illustration 48.

Maanika, Bhavi and Komal are partners sharing profits in the ratio of 6 : 4 : 1. Komal is guaranteed a minimum profit of ₹ 2,00,000. The firm incurred a loss of ₹ 22,00,000 for the year ended 31st March, 2018. Pass necessary Journal entry regarding deficiency borne by Maanika and Bhavi and prepare Profit and Loss Appropriation Account. (*CBSE Sample Paper 2019*)

Solution:

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 March 31	Maanika's Capital A/c ...Dr.		2,40,000	
	Bhavi's Capital A/c ...Dr.		1,60,000	
	To Komal's Capital A/c			4,00,000
	(Deficiency of Komal met by Maanika and Bhavi) (WN)			

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *for the year ended 31st March, 2018* *Cr.*

Particulars	₹	Particulars	₹
To Net Loss (Profit and Loss A/c)	22,00,000	By Loss transferred to:	
		Maanika's Capital A/c	12,00,000
		Bhavi's Capital A/c	8,00,000
		Komal's Capital A/c	2,00,000
	22,00,000		22,00,000

Working Note:

Loss of the firm = ₹ 22,00,000

Komal's share of loss = ₹ 22,00,000 × 1/11 = ₹ 2,00,000

Guaranteed minimum profit = ₹ 2,00,000

Therefore, Komal's Capital Account is to be credited by the amount of deficiency ₹ 4,00,000 (*i.e.*, ₹ 2,00,000: Share of Loss + ₹ 2,00,000 : Guaranteed Profit) which will be borne by Maanika and Bhavi in their profit-sharing ratio, *i.e.*, 6 : 4 or 3 : 2.

Illustration 49.

A, *B* and *C* are partners in a firm sharing profits in the ratio of 4 : 2 : 1. It is provided that *C*'s share in profit would not be less than ₹ 37,500. Profit for the year ended 31st March, 2020 was ₹ 1,57,500.

Prepare Profit and Loss Appropriation Account.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2020

Dr. *Cr.*

Particulars		₹	Particulars	₹
To *A*'s Capital A/c	90,000		By Profit and Loss A/c	1,57,500
Less: *C*'s Share of Deficiency	10,000	80,000	—Net Profit	
To *B*'s Capital A/c	45,000			
Less: *C*'s Share of Deficiency	5,000	40,000		
To *C*'s Capital A/c	22,500			
Add: Deficiency met by:				
A	10,000			
B	5,000	37,500		
		1,57,500		1,57,500

Working Notes:

1. DISTRIBUTION OF PROFIT

Particulars	*A*	*B*	*C*
Divide Net Profit of ₹ 1,57,500 in 4 : 2 : 1.	₹ 1,57,500 × 4/7 = ₹ 90,000	₹ 1,57,500 × 2/7 = ₹ 45,000	₹ 1,57,500 × 1/7 = ₹ 22,500
However, *C*'s Minimum Guaranteed Profit = ₹ 37,500. Thus, deficiency is of ₹ 37,500 – ₹ 22,500 = ₹ 15,000.			
Deficiency met by *A* and *B* in 4 : 2 or 2 : 1	₹ 15,000 × 2/3 = ₹ 10,000	₹ 15,000 × 1/3 = ₹ 5,000	...
Share of Profit	₹ 90,000 – ₹ 10,000 = ₹ 80,000	₹ 45,000 – ₹ 5,000 = ₹ 40,000	₹ 22,500 + ₹ 10,000 (*A*) + ₹ 5,000 (*B*) = ₹ 37,500

2. Since no specific ratio is given in which the deficiency is to be met, it means *A* and *C* shall meet the deficiency in their profit-sharing ratio, *i.e.*, 4 : 2 or 2 : 1.

Illustration 50.

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

Prepare Profit and Loss Appropriation Account of P, Q and R for the year ended 31st March, 2015. (*Delhi 2016*)

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

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

Particulars		₹	Particulars	₹
To Net Profit transferred to:			By Profit and Loss A/c (Net Profit)	4,00,000
P's Capital A/c	2,18,750			
Less: Deficiency in *R*'s Share	15,000	2,03,750		
Q's Capital A/c	1,31,250			
Less: Deficiency in *R*'s Share	10,000	1,21,250		
R's Capital A/c	50,000			
Add: Deficiency met by:				
P	15,000			
Q	10,000	75,000		
		4,00,000		4,00,000

Working Notes:

1. *Calculation of New Profit-sharing Ratio of P, Q and R:*
   Let the total share be 1
   Share of incoming partner R=1/8
   Remaining Share = 1 – 1/8 = 7/8
   P's New Share = 7/8 × 5/8 = 35/64
   Q's New Share = 7/8 × 3/8 = 21/64
   R's Share = 1/8 or 8/64
   Thus, New Profit-sharing Ratio of P, Q and R = 35/64 : 21/64 : 8/64, *i.e.*, 35 : 21 : 8.
2. R's Share of Profit = 1/8 of ₹ 4,00,000 = ₹ 50,000; whereas, R's guaranteed profit = ₹ 75,000.
   Deficiency in R's share (₹ 25,000) is to be met by P and Q in the ratio of 3 : 2. Thus, P and Q will meet the deficiency of ₹ 15,000 and ₹ 10,000 respectively.

Illustration 51.

Moli, Bhola and Raj were partners in a firm sharing profits and losses in the ratio of 3 : 3 : 4. Their Partnership Deed provided for the following:

(i) Interest on capitals @ 5% p.a.

(ii) Interest on drawings @ 12% p.a.

(iii) Interest on partners' loan @ 6% p.a.

(iv) Moli was allowed an annual salary of ₹ 4,000; Bhola was allowed a commission of 10% of net profit as shown by Profit and Loss Account and Raj was guaranteed a profit of ₹ 1,50,000 after making all the adjustments as provided in the partnership agreement.

Their fixed capitals were Moli: ₹ 5,00,000; Bhola: ₹ 8,00,000 and Raj: ₹ 4,00,000. On 1st April, 2016 Bhola extended a loan of ₹ 1,00,000 to the firm. The net profit of the firm for the year ended 31st March, 2017 before interest on Bhola's loan was ₹ 3,06,000.

Prepare Profit and Loss Appropriation Account of Moli, Bhola and Raj for the year ended 31st March, 2017 and their Current Accounts assuming that Bhola withdrew ₹ 5,000 at the end of each month, Moli withdrew ₹ 10,000 at the end of each quarter and Raj withdrew ₹ 40,000 at the end of each half year. (*Delhi 2018*)

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2017

Dr. *Cr.*

Particulars		₹	Particulars		₹
To Interest on Capital A/cs:			By Profit and Loss A/c	3,06,000	
Moli's Current A/c	25,000		(Profit as per Profit and Loss A/c)		
(₹ 5,00,000 × 5/100)			*Less:* Interest on Bhola's Loan	6,000	3,00,000
Bhola's Current A/c	40,000		By Interest on Drawings: (WN 1)		
(₹ 8,00,000 × 5/100)			Moli's Current A/c	1,800	
Raj's Current A/c	20,000	85,000	Bhola's Current A/c	3,300	
(₹ 4,00,000 × 5/100)			Raj's Current A/c	2,400	7,500
To Moli's Current A/c (Salary)		4,000			
To Bhola's Current A/c (Commission)		30,000			
(₹ 3,00,000 × 10/100)					
To Profit transferred to: (WN 2)					
Moli's Current A/c	56,550				
(₹ 1,88,500 × 3/10)					
Less: Given to Raj	37,300	19,250			
Bhola's Current A/c	56,550				
(₹ 1,88,500 × 3/100)					
Less: Given to Raj	37,300	19,250			
Raj's Current A/c	75,400				
(₹ 1,88,500 × 4/10)					
Add: From Moli	37,300				
From Bhola	37,300	1,50,000			
		3,07,500			3,07,500

PARTNERS' CURRENT ACCOUNTS

Dr. *Cr.*

Particulars	Moli ₹	Bhola ₹	Raj ₹	Particulars	Moli ₹	Bhola ₹	Raj ₹
To Drawings A/c	40,000	60,000	80,000	By Interest on Capital A/c	25,000	40,000	20,000
To Interest on				By Salary A/c	4,000	...	...
Drawings A/c	1,800	3,300	2,400	By Commission A/c	...	30,000	...
To Balance *c/d*	6,450	25,950	87,600	By Profit and Loss			
				Appropriation A/c	19,250	19,250	1,50,000
				(Profit)			
	48,250	89,250	1,70,000		48,250	89,250	1,70,000

Working Notes:

1. *Calculation of Interest on Drawings:*

(a) *Interest on Moli's Drawings:* ₹ 40,000 (*i.e.*, ₹ 10,000 × 4 Instalments) × 4.5/12 months* × 12/100 = ₹ 1,800.

(b) *Interest on Bhola's Drawings:* ₹ 60,000 (*i.e.*, ₹ 5,000 × 12 months) × 5.5/12 months* × 12/100 = ₹ 3,300.

(c) *Interest on Raj's Drawings:* ₹ 80,000 (*i.e.*, ₹ 40,000 × 2 instalments) × 3/12 months* × 12/100 = ₹ 2,400.

$$\text{*Average period} = \frac{\text{Months Left after First Drawing + Months Left after Last Drawing}}{2}$$

(a) Average period in case of Moli = $\frac{9+0}{2}$ = 4.5 Months.

(b) Average period in case of Bhola = $\frac{11+0}{2}$ = 5.5 Months.

(c) Average period in case of Raj = $\frac{6+0}{2}$ = 3 Months.

We apply average period for the calculation of interest on drawings when a uniform amount is withdrawn at regular interval.

2. *Distribution of Profit:*

Profit after adjustments (₹ 3,00,000 + ₹ 7,500 – ₹ 85,000 – ₹ 4,000 – ₹ 30,000) = ₹ 1,88,500 will be distributed among Moli, Bhola and Raj in the ratio of 3 : 3 : 4.

Moli's share of profit = ₹ 56,550, Bhola's share of profit = ₹ 56,550, and Raj's share of profit = ₹ 75,400.

However, Raj's minimum guaranteed profit is ₹ 1,50,000. So there is a deficiency of ₹ 74,600 (*i.e.*, ₹ 1,56,000 – ₹ 75,400). Deficiency to be borne by Moli and Bhola equally, *i.e.*, ₹ 37,300 each.

(b) **Guarantee of Profit by one or more of the Existing or Old Partners**

When one of the existing or old partners (in some cases more than one partner) guarantee minimum profit, the adjustment is made through the Partners' Capital Accounts. Following steps are to be followed:

Step 1: Distribute the profit among the partners as per their profit-sharing ratio.

Step 2: If share of profit of the guaranteed partner is less than the minimum guaranteed profit the difference is deducted from the share of profit of the partner (or partners) who has guaranteed and it is added to the share of profit of the guaranteed partner.

When two or more partners guarantee, the shortfall (deficiency) is shared by them in the agreed ratio or in their profit-sharing ratio as the case may be.

Illustration 52.

P, *Q* and *R* are partners sharing profits in the ratio of 5 : 4 : 1 respectively. *R* is guaranteed that his share of profit in any year will be at least ₹ 50,000. Profit for the year ended 31st March, 2020 is ₹ 3,50,000. Amount of shortfall in the profits of *R* is to be met by *P* and *Q* in the ratio of 3 : 2. Pass necessary Journal entry regarding deficiency met by *P* and *Q*.

Solution:

In the Books of the Firm

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2020				
March 31	*P*'s Capital A/c ...Dr.		9,000	
	Q's Capital A/c ...Dr.		6,000	
	To *R*'s Capital A/c			15,000
	(Shortfall in the share of profit of *R*, met by *P* and *Q* in the ratio of 3 : 2)			

Working Note:

When the net profit of ₹ 3,50,000 is distributed amongst the partners in the ratio of 5 : 4 : 1, *R* gets ₹ 35,000 (*i.e.*, ₹ 3,50,000 × 1/10). But his guaranteed profit is ₹ 50,000. The shortfall, ₹ 15,000 (*i.e.*, ₹ 50,000 – ₹ 35,000) is to be met by *P* and *Q* in the ratio of 3 : 2 respectively. In effect, shortfall met by *P* is ₹ 9,000 (*i.e.*, ₹ 15,000 × 3/5) and shortfall met by *Q* is ₹ 6,000 (*i.e.*, ₹ 15,000 × 2/5).

Illustration 53 (*Guarantee of Profits by one of the Partners*).

X, *Y* and *Z* are partners in a firm. Their profit-sharing ratio is 5 : 3 : 2. *Z* is guaranteed a minimum profit of ₹ 10,000 every year. Any deficiency arising is to be met by *Y*. Profits for the two years ended 31st March, 2019 and 2020 were ₹ 40,000 and ₹ 60,000 respectively.

Prepare Profit and Loss Appropriation Account for the two years.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2019

Dr. *Cr.*

Particulars		₹	Particulars	₹
To Profit transferred to:			By Profit and Loss A/c	40,000
X's Capital A/c (5/10)		20,000	(Net Profit)	
Y's Capital A/c (3/10)	12,000			
Less: Deficiency in *Z*'s Share	2,000	10,000		
Z's Capital A/c (2/10)	8,000			
Add: Deficiency met by *Y*	2,000	10,000		
		40,000		40,000

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

Particulars	₹	Particulars	₹
To Profit transferred to:		By Profit and Loss A/c	60,000
X's Capital A/c (5/10)	30,000	(Net Profit)	
Y's Capital A/c (3/10)	18,000		
Z's Capital A/c (2/10)	12,000		
	60,000		60,000

Note: *Z*'s share in profits is more than the minimum guaranteed amount, so there is no need for any adjustment.

Illustration 54.

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

Biswas's share of profit including interest on capital but excluding salary is guaranteed at a minimum of ₹ 82,000 p.a. Any deficiency arising on that account shall be met by Divya. Profit for the year ended 31st March, 2014 amounted to ₹ 3,12,000. Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2014. *(Delhi 2013)*

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2014

Dr. Particulars		₹	Particulars	₹ *Cr.*
To Interest on Capital A/cs:			By Profit and Loss A/c	3,12,000
Anwar	48,000		(Net Profit)	
Biswas	36,000			
Divya	24,000	1,08,000		
To Partners' Salary A/c:				
Biswas (₹ 4,000 × 12)	48,000			
Divya (₹ 6,000 × 4)	24,000	72,000		
To Profit transferred to:				
Anwar's Capital A/c (₹ 1,32,000 × 3/6)		66,000		
Biswas' Capital A/c (₹ 1,32,000 × 2/6)	44,000			
Add: From Divya (Note)	2,000	46,000		
Divya's Capital A/c (₹ 1,32,000 × 1/6)	22,000			
Less: Deficiency borne	2,000	20,000		
		3,12,000		3,12,000

Note: A. Biswas's Share of Profit ₹ 44,000
Add: Interest on Capital ₹ 36,000
₹ 80,000

B. Guaranteed Profit = ₹ 82,000

C. Deficiency to be borne by Divya (*B* – *A*) = ₹ 82,000 – ₹ 80,000 = ₹ 2,000.

Illustration 55 (*Guarantee of Profit when partnership starts during the year*).

X, *Y* and *Z* entered into partnership on 1st July, 2019 to share Profit and Losses in the ratio of 3 : 2 : 1. *X* guaranteed that *Z*'s share of profit after charging interest on capitals @ 6% per annum would not be less than ₹ 36,000 p.a. The capital contributed by *X*—₹ 2,00,000; *Y*—₹ 1,00,000 and *Z*—₹ 1,00,000. Profit for the year ended 31st March, 2020 was ₹ 1,38,000. Prepare Profit and Loss Appropriation Account.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2020

Dr. Particulars		₹	Particulars	₹ *Cr.*
To Interest on Capital A/cs (WN 1):			By Profit and Loss A/c	1,38,000
X	9,000		(Net Profit)	
Y	4,500			
Z	4,500	18,000		
To Profit transferred to (WN 2):				
X's Capital A/c	53,000			
Y's Capital A/c	40,000			
Z's Capital A/c	27,000	1,20,000		
		1,38,000		1,38,000

Working Notes:

1. *Calculation of Interest on Capital on:*

   X's Capital = ₹ 9,000 (*i.e.*, ₹ 2,00,000 × 6/100 × 9/12); *Y*'s Capital = ₹ 4,500 (*i.e.*, ₹ 1,00,000 × 6/100 × 9/12); *Z*'s Capital = ₹ 4,500 (*i.e.*, ₹ 1,00,000 × 6/100 × 9/12).

2. (i) Profit after interest on Capital = ₹ 1,38,000 – ₹ 18,000 = ₹ 1,20,000

   Profit of ₹ 1,20,000 will be distributed between *X*, *Y* and *Z* in the ratio 3 : 2 : 1, *i.e.*,

   X's Share of Profit = ₹ 60,000; *Y*'s Share of Profit = ₹ 40,000; and *Z*'s Share of Profit = ₹ 20,000.

(ii) *Z*'s Share of Profit = ₹ 20,000. However, due to guarantee, *Z* has to get minimum ₹ 27,000* (*i.e.*, ₹ 36,000 × 9/12) of profit for 9 months. So, deficiency of ₹ 7,000 (*i.e.*, ₹ 27,000 – ₹ 20,000) will be paid by *X*. After adjusting the deficiency of profit by *X*, *X*'s Share of profit will be ₹ 53,000 (*i.e.*, ₹ 60,000 – ₹ 7,000) and *Z*'s Share of Profit = ₹ 20,000 + ₹ 7,000 = ₹ 27,000.

* *Guaranteed amount is calculated on proportionate basis from the date of admission of Guaranteed partner to the closing date of accounting year.*

Accounting treatment of Guarantee of minimum profit to a partner in case of Loss

It is possible that the firm has incurred loss but minimum guaranteed profit is to be paid to the partner who has been guaranteed minimum profit. In such case, adjustment is made through Partners' Capital Accounts in the following manner:

(i) Distribute loss among the partners in their profit-sharing ratio.

(ii) Capital account of the guaranteed partner is credited with guaranteed minimum profit *plus* the amount of loss. This amount is debited to remaining partners in their profit-sharing ratio or to the debit of the partner who has guaranteed minimum profit.

Illustration 56 (*Guarantee of Profit to a Partner in Case of Loss*).

A, *B* and *C* are partners having capitals of ₹ 10,00,000; ₹ 8,00,000 and ₹ 6,00,000 respectively in a firm and sharing profits and losses equally. *C* is guaranteed a minimum profit of ₹ 1,00,000 as share of profit every year. The firm incurred a loss of ₹ 3,00,000 for the year ended 31st March, 2020. You are required to show the necessary accounts for division of loss and giving effect to minimum guaranteed profit to *C*.

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT
for the year ended 31st March, 2020

Dr. *Cr.*

Particulars	₹	Particulars	₹
To Profit and Loss A/c (Net Loss)	3,00,000	By Loss transferred to:	
		A's Capital A/c	1,00,000
		B's Capital A/c	1,00,000
		C's Capital A/c	1,00,000
	3,00,000		3,00,000

PARTN1ERS' CAPITAL ACCOUNTS

Dr. *Cr.*

Particulars	*A* (₹)	*B* (₹)	*C* (₹)	Particulars	*A* (₹)	*B* (₹)	*C* (₹)
To Profit and Loss Appropriation A/c	1,00,000	1,00,000	1,00,000	By Balance *b/d*	10,00,000	8,00,000	6,00,000
To *C*'s Capital A/c (Guaranteed Profit)	1,00,000	1,00,000	...	By *A*'s Capital A/c	...	...	1,00,000
To Balance *c/d*	8,00,000	6,00,000	7,00,000	By *B*'s Capital A/c	...	...	1,00,000
	10,00,000	8,00,000	8,00,000		10,00,000	8,00,000	8,00,000
				By Balance *b/d*	8,00,000	6,00,000	7,00,000

Note: *C* is guaranteed a profit of ₹ 1,00,000 p.a. Loss incurred by the firm is ₹ 3,00,000. Out of which ₹ 1,00,000 is debited to *C*'s Capital Account. Therefore, *C*'s Capital Account is to be credited by the amount of deficiency ₹ 2,00,000 (₹ 1,00,000 share of loss debited *plus* ₹ 1,00,000 guaranteed profit) which is met equally by *A* and *B*.

Alternative Method:

Particulars	Total (₹)	*A* (₹)	*B* (₹)	*C* (₹)
I. Loss for the year as per Profit and Loss Account to be debited to *A* and *B* equally as *C* is guaranteed minimum profit	(3,00,000)	(1,50,000)	(1,50,000)	...
II. Guaranteed profit of *C* to be shared by *A* and *B* equally	...	(50,000)	(50,000)	1,00,000
III. Net Effect	(3,00,000)	(2,00,000)	(2,00,000)	1,00,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	A (₹)	B (₹)	C (₹)	Particulars	A (₹)	B (₹)	C (₹)
To Profit and Loss App. A/c	1,50,000	1,50,000	...	By Balance *b/d*	10,00,000	8,00,000	6,00,000
To *C's* Capital A/c (Guaranteed Profit)	50,000	50,000	...	By *A's* Capital A/c	...	...	50,000
				By *B's* Capital A/c	...	...	50,000
To Balance *c/d*	8,00,000	6,00,000	7,00,000				
	10,00,000	8,00,000	7,00,000		10,00,000	8,00,000	7,00,000

Illustration 57 (*Guarantee of Profit by the Firm*).

A, *B* and *C* are partners in a firm sharing profits and losses in the ratio of 12 : 8 : 5. Partner *C* is guaranteed a minimum profit of ₹ 50,000 p.a. by the firm. The profits and losses for the years ended 31st March, were: 2018—Profit ₹ 2,00,000; 2019—Profit ₹ 3,00,000, and 2020—Loss ₹ 2,00,000. Pass necessary Journal entries in the books of the firm.

Solution:

Particulars	31st March, 2018 (₹)	31st March, 2019 (₹)	31st March, 2020 (₹)
(i) Guaranteed Profit to *C*	50,000	50,000	50,000
(ii) *C's* Actual Share of Profit as per profit-sharing ratio 12 : 8 : 5	40,000	60,000	(40,000) Loss
	(*i.e.*, ₹ 2,00,000 × 5/25)	(*i.e.*, ₹ 3,00,000 × 5/25)	(*i.e.*, ₹ 2,00,000 × 5/25)
(iii) Deficiency [(i) – (ii)]	10,000	...	90,000

The deficiency in *C*'s share of profit is to be borne by the firm. Thus, out of the profit of the firm *C*'s Capital Account will be credited with minimum guaranteed profit or his share of profit, which ever is higher and thereafter, balance will be distributed to *A* and *B* in their profit-sharing ratio.

In case of loss, loss will be debited to Partners' Capital Accounts and thereafter, deficiency in guaranteed partner's share will be debited to remaining Partners' Capital Accounts.

JOURNAL

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
2018 March 31	Profit and Loss A/c ...Dr.		2,00,000	
	To Profit and Loss Appropriation A/c			2,00,000
	(Net profit transferred to Profit and Loss Appropriation Account)			
	Profit and Loss Appropriation A/c ...Dr.		2,00,000	
	To *A's* Capital A/c			90,000
	To *B's* Capital A/c			60,000
	To *C's* Capital A/c			50,000
	(Distribution of profit among partners and *C* credited with his guaranteed profit)			
2019 March 31	Profit and Loss A/c ...Dr.		3,00,000	
	To Profit and Loss Appropriation A/c			3,00,000
	(Profit transferred to Profit and Loss Appropriation Account)			
	Profit and Loss Appropriation A/c ...Dr.		3,00,000	
	To *A's* Capital A/c (₹ 3,00,000 × 12/25)			1,44,000
	To *B's* Capital A/c (₹ 3,00,000 × 8/25)			96,000
	To *C's* Capital A/c (₹ 3,00,000 × 5/25)			60,000
	(Net profit distributed among the partners in the ratio of 12 : 8 : 5)			

2020 March 31	*A*'s Capital A/c ...Dr.		96,000	
	B's Capital A/c ...Dr.		64,000	
	C's Capital A/c ...Dr.		40,000	
	To Profit and Loss A/c			2,00,000
	(Distribution of loss as if there is no guarantee)			
	A's Capital A/c ...Dr.		54,000	
	B's Capital A/c ...Dr.		36,000	
	To *C*'s Capital A/c			90,000
	(Deficiency of *C*, met by *A* and *B* in the ratio of 3 : 2)			

Minimum Earnings Guaranteed by a Partner

A partner may guarantee minimum fee or specified amount that the firm shall earn by his efforts. Shortfall, if any is borne by the partner guaranteeing the fee or amount specfied. For example, Rohit, a partner guarantees the firm that he shall bring only additional fee of ₹ 1,00,000 in a year but is able to bring only ₹ 90,000 as fee. The shortfall of ₹ 10,000 will be debited to his Capital Account (in case of fixed capitals) or Current Account (in case of fluctuating capitals).

Illustration 58.

Jay, Vijay and Karan were partners of an architect firm sharing profits in the ratio of 2 : 2 : 1. Their Partnership Deed provided the following:

(i) A monthly salary of ₹ 15,000 each to Jay and Vijay.

(ii) Karan was guaranteed a profit of ₹ 5,00,000 and Jay guaranteed that he will earn an annual fee of ₹ 2,00,000. Any deficiency arising because of guarantee to Karan will be borne by Jay and Vijay in the ratio of 3 : 2.

During the year ended 31st March, 2018 Jay earned fee of ₹ 1,75,000 and the profits of the firm amounted to ₹ 15,00,000.

Showing your workings clearly prepare Profit and Loss Appropriation Account and the Capital Accounts of Jay, Vijay and Karan for the year ended 31st March, 2018. *(CBSE 2019)*

Solution:

PROFIT AND LOSS APPROPRIATION ACCOUNT

for the year ended 31st March, 2018

Dr. *Cr.*

Particulars		₹	Particulars	₹
To *Partners' Salary:*			By Profit and Loss A/c (Net Profit)	15,00,000
Jay's Capital A/c	1,80,000		By Jay's Capital A/c (₹ 2,00,000 – ₹ 1,75,000)	25,000
Vijay's Capital A/c	1,80,000	3,60,000	(Deficiency in Guaranteed Fees)	
To Profit transferred to:				
Jay's Capital A/c	4,66,000			
Less: Guaranteed (Profit to Karan)	1,60,200	3,05,800		
Vijay's Capital A/c	4,66,000			
Less: Guaranteed (Profit to Karan)	1,06,800	3,59,200		
Karan's Capital A/c	2,33,000			
Add: Deficiency met by Jay and Vijay	2,67,000	5,00,000		
		15,25,000		15,25,000

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	Jay ₹	Vijay ₹	Karan ₹	Particulars	Jay ₹	Vijay ₹	Karan ₹
To Profit and Loss Appropriation A/c	25,000	...	...	By Partners' Salary A/c	1,80,000	1,80,000	...
To Balance *c/d*	4,60,800	5,39,200	5,00,000	By Profit and Loss Appropriation A/c—Profit	3,05,800	3,59,200	5,00,000
	4,85,800	5,39,200	5,00,000		4,85,800	5,39,200	5,00,000

Working Note: *Calculation of Deficiency in Karan's share and its recovery:*

Profit to be Distributed = ₹ 15,00,000 – ₹ 3,60,000 + ₹ 25,000 = ₹ 11,65,000.

Division of Profit: Jay's Share of Profit = ₹ 11,65,000 × 2/5 = ₹ 4,66,000;

Vijay's Share of Profit = ₹ 11,65,000 × 2/5 = ₹ 4,66,000;

Karan's Share of Profit = ₹ 11,65,000 × 1/5 = ₹ 2,33,000.

Karan's Deficiency = Guaranteed profit – Karan's Share of Profit

= ₹ 5,00,000 – ₹ 2,33,000 = ₹ 2,67,000, which will be met by Jay and Vijay in the ratio of 3 : 2

Deficiency borne by: Jay = ₹ 2,67,000 × 3/5 = ₹ 1,60,200; Vijay = ₹ 2,67,000 × 2/5 = ₹ 1,06,800.

Scan QR Code for Additional Illustrations

QUESTIONS

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) If the Partnership Deed does not exist or where it exists, it does not provide for interest on loan by the partner, partners will get interest @ 6% on the loan given by them to the firm.

(ii) In the absence of an agreement, profits and losses are distributed among the partners equally.

(iii) A partner who devotes more time to a business than others is entitled to get salary, even if the partnership is without Partnership Deed.

(iv) A partner who has invested more capital in the firm will get interest on excess capital.

(v) When a partner draws a fixed amount for his personal use at the end of each month for 12 months, interest will be charged at an agreed rate per annum on total amount of drawings for 5½ months.

(vi) When a partner draws a fixed amount for his personal use in the middle of each month for 12 months, interest will be charged at an agreed rate per annum on total amount of drawings for 6 months.

(vii) If the Partnership Deed is silent, interest @ 6% p.a. will be charged on the drawings made by the partner.

(viii) Interest on loan by a partner to the firm is allowed @ 10% p.a. if the Partnership Deed does not exist or is silent about the rate of interest.

(ix) Valid partnership can be set up even without a written agreement between the partners.

(x) Partners are mutual agents of each other so far as the business of the firm is concerned.

(xi) A partnership should have at least two partners but the number of partners should not exceed fifty.

(xii) Partnership is a business entity which is not separate from its partners in any circumstances.

(xiii) The Partnership Deed provides to pay salary/commission to partners @ 2% of Net Sales. It will be paid even if the firm incurs loss.

(xiv) In the absence of Partnership Deed or agreement, profits and losses are shared equally by the partners.

(xv) A partner can retire from the partnership with the consent of all the partners, even if the partnership is at will.

(xvi) Amrish, a partner, has taken loan from the firm without an agreement. The firm shall charge interest @ 6% p.a. from Amrish.

(xvii) Rent paid to a partner for use of his personal property for business is debited to Profit and Loss Account.

(xviii) The Partnership Deed allows salary/commission to the partners. The firm incurs loss during the year but has accumulated profits. Salary/Commission will be paid out of accumulated profits.

(xix) A firm is started on 1st October, 2019 and the partners draw fixed amount at the end of each month. Interest will be charged at the agreed rate of interest for 2.5 months.

(xx) Partners draw fixed amount at the end of each month from 1st April, 2019 for six months. Interest will be charged at the agreed rate of interest for 3.5 months for the year ended 31st March, 2020.

2. *Fill-in-the blanks with **appropriate** words:*

(i) Current Accounts of the Partners should be opened when the capitals are _______________.

(ii) In the absence of an agreement, interest on loan by partner is allowed @ _______________.

(iii) If the Partnership Deed does not exist or where it exists does not provide for salary to partners, partners shall not be allowed salaries, if the firm does not earn _______________ during the year.

(iv) When there is no agreement among the partners, the profit or loss of the firm will be shared _______________ by the partners.

(v) The extension of Profit and Loss Account is _______________.

(vi) Minimum number of persons required to start partnership business is _______________.

(vii) Number of partners which should not exceed for partnership business is _______________.

(viii) Salary or Commission to a partner is an _______________ of profit.

(ix) Interest on Capital is allowed only if the firm earns _______________ during the year.

(x) Having a written Partnership Deed is _______________.

(xi) Remuneration to Partners is an appropriation of profit and therefore it is debited to _______________.

(xii) Every partner is bound to attend diligently to his _______________ in the conduct of the business.

(xiii) Interest on drawings is charged if the Partnership Deed provides for it, whether the firm earns ____________ or incurs _______________.

(xiv) Interest on Loan taken by a partner is credited to _______________.

(xv) _______________ can override the provisions of Indian Partnership Act, 1932.

(xvi) In case of guarantee of minimum profit to a partner deficiency of guaranteed partner is met by remaining partners in their _______________.

(xvii) Manager's Commission is a _______________ against profit.

(xviii) Current Accounts of the Partners are not opened when the Capitals are _______________.

(xix) If a fixed amount is withdrawn by a partner on the last day of every month for a year, interest on the total amount of drawings is charged for _______________ months.

(xx) In case of partnership, the act of any partner is binding on _______________ partners.

3. ***Match*** *the following:*

1. (i) According to Companies Act, 2013 maximum numbers of partners in a firm can be — (a) 50 (b) 100
2. (i) Item which may be debited to Partner's Capital Account — (a) Interest on Capital
   (ii) Item which may be credited to Partner's Capital Account — (b) Interest on Drawings
3. (i) Rent paid to partner — (a) Charge against profit
   (ii) Salary paid to partner — (b) Appropriation of Profit
   (c) Both
4. (i) Remuneration to partner — (a) Not paid to any partner in the absence of Partnership Deed
   (ii) Interest on Loan by Partner — (b) Paid @ 6% p.a..
   (c) Not charged from partners
5. (i) When drawings are made at the end of each quarter — (a) 6 months
   (ii) When drawings are made in middle of each quarter — (b) 7.5 months
   (c) 4.5 months
6. (i) Guaranteed profit is allowed even in case of — (a) loss
   (b) profit
   (c) both
7. (i) Partners' Current Accounts are opened when their Capital Accounts are — (a) fixed
   (ii) Partners' Capital Accounts are opened when their Capital Accounts are — (b) fluctuating
   (c) both
   (d) none
8. (i) Product method is used when — (a) amount of drawing and period is uniform
   (b) there is irregular drawings
   (c) time intervals between the two drawings is also uniform

Multiple Choice Questions (MCQs)

Select the ***correct*** *alternative:*

1. The written agreement among the partners is called
(a) Partnership Deed. (b) Partnership buy laws.
(c) Partnership Constitution. (d) a contract.

2. The liability of the partners in a partnership firm under Indian Partnership Act, 1932 is
(a) Limited. (b) Unlimited.
(c) No Liability. (d) Depending on the situation.

3. Interest on Capital is allowed on
(a) the opening capital. (b) the capital at the year end.
(c) average capital of the year. (d) the capital in the middle of the year.

4. In the absence of the Partnership Deed, Interest on Capital
(a) is allowed @ 6% per annum. (b) is allowed @ 10% per annum.
(c) is allowed at the borrowing rate. (d) is not allowed.

5. In case of fixed capitals, partners will have
   (a) credit balances in their Capital Accounts.
   (b) debit balances in their Capital Accounts.
   (c) may have credit or debit balances in their Capital Accounts.
   (d) credit balance or nil balance in their Capital Accounts.

6. In case of fixed capitals, interest on capital
   (a) is credited to Partner's Capital Account.
   (b) is credited to Partner's Current Account.
   (c) may be credited to Partner's Capital or Current Account.
   (d) is debited to Partner's Capital Account.

7. In case of fluctuating capitals, interest on capital
   (a) is credited to Partner's Capital Account.
   (b) is credited to Partner's Current Account.
   (c) may be credited to Partner's Capital or Current Account.
   (d) Interest Payable Account.

8. Current Accounts of partners are maintained if
   (a) capitals are fixed.
   (b) capitals are fluctuating.
   (c) whether capitals are fixed or fluctuating.
   (d) as is decided by the Partners.

9. In the absence of Partnership Deed, profit of a firm is divided among the partners
   (a) in the ratio of capital.
   (b) Equally.
   (c) in the ratio of time devoted for the firm's business.
   (d) According to the managerial abilities of the partners. (*CBSE 2015*)

10. Interest on Capitals of Partners under the Fluctuating Capital Accounts Method is credited to
   (a) Interest Payable Account.
   (b) Profit and Loss Account.
   (c) Partners' Capital Accounts.
   (d) Partners' Current Accounts.

11. When guarantee is given to partner by some partners, deficiency on such guarantee will be borne by
   (a) All of the other partners.
   (b) Partnership firm.
   (c) Partner who gave the guarantee.
   (d) None of the partners.

12. In the absence of an agreement to the contrary, the partners are
   (a) entitled to 6% interest on their capitals, only when there are profits.
   (b) entitled to 9% interest on their capitals, only when there are profits.
   (c) entitled to interest on their capitals at the bank rate, only when there are profits.
   (d) not entitled to interest on their capitals.

13. Which of the following items will not be shown in Profit and Loss Appropriation Account?
   (a) Interest on Capital
   (b) Commission to a partner
   (c) Interest on Drawings
   (d) Interest on Partner's Loan

14. Which of the following items will not be shown in the debit of Profit and Loss Appropriation Account?
   (a) Interest on Capital
   (b) Commission to a partner
   (c) Interest on Drawings
   (d) Salary to partners

15. Which of the following is not an essential feature of partnership?

(a) An agreement, oral or written, should exist among the partners.

(b) Agreement should be to carry on lawful business.

(c) All the partners should contribute capital in the firm.

(d) There should be at least two partners.

16. A manager gets 5% commission on net profit after charging such commission, gross profit ₹ 5,80,000 and expenses of indirect nature other than manager's commission are ₹ 1,60,000. Commission amount will be

(a) ₹ 21,000. (b) ₹ 20,000.

(c) ₹ 15,000. (d) ₹ 22,000.

17. If the Partnership Deed provides for payment of interest on capital of the partners, then interest can be paid only out of

(a) Accumulated Profits. (b) Past Profits.

(c) Current Profits. (d) Total Profits.

18. As per Indian Partnership Act, 1932 if Partnership Deed does not exist partners are entitled to

(a) Salary. (b) Interest on Capital.

(c) Equal Profit Share. (d) Commission.

19. Relationship between the partners is of

(a) Close relatives. (b) Agent and principal.

(c) Junior-senior relationship. (d) Senior-subordinate Relationship.

20. There are **two** partners in a firm *P* and *Q*. *R* is admitted into the firm for 1/3rd share of profit with the guaranteed profit of ₹ 18,000 p.a. The firm's total profit is ₹ 42,000. If *P* stood as guarantor of guaranteed profit to *R,* how much profit would be given to *P?*

(a) ₹ 20,000 (b) ₹ 15,000

(c) ₹ 10,000 (d) ₹ 18,000

21. In the absence of Partnership Agreement, interest on drawings of a partner is charged

(a) @ 8% per annum (b) @ 9% per annum

(c) @ 12% per annum (d) No interest is charged (*CBSE, Foreign 2015*)

22. In the absence of Partnership; interest on loan of a partner is allowed

(a) @ 8% per annum (b) @ 6% per annum

(c) No interest is allowed (d) @ 12% per annum (*CBSE, AI 2015*)

Very Short Answer Type Questions

1. Define Partnership.
2. State **any two** essential features or characteristics of partnership other than minimum number of partners and profit sharing.
3. Does partnership firm has a separate legal entity? Give reason in support of your answer. *(Delhi 2017)*
4. What is the maximum number of partners that a partnership firm can have? Name the Act that provides for the maximum number of partners in a partnership firm. *(Delhi and Foreign 2016)*
5. Ritesh and Hitesh are childhood friends. Ritesh is a consultant whereas Hitesh is an architect. They contributed equal amounts and purchased a building for ₹ 2 crores. After a year, they sold it for ₹ 3 crores and shared the profits equally. Are they doing the business in partnership ? Give reason in support of your answer. *(Delhi 2018)*

6. A group of 40 people want to form a partnership firm. They want your advice regarding the maximum number of persons that can be there in a partnership firm and name of the Act under whose provision it is given. *(AI 2016)*
7. Is there any restriction on maximum number of partners? If yes, name the Act under which it is prescribed.
8. Does a partner has right not to allow admission of a new partner, if the Partnership Deed does not exist?
9. State **any two** rights of a partner besides profits of business, participating in business and right to be consulted about affairs of the business.
10. What is a Partnership Deed? *(Foreign 2004, Delhi 2010)*
11. Why is it considered better to make a partnership agreement in writing? *(NCERT)*
12. *X* and *Y* are partners. *Y* wants to admit his son *K* into business. Can *K* become the partner of the firm? Give reason. *(Delhi 2014 C)*
13. Pratibha, partner of a firm, has advanced loan to the firm of ₹ 1,00,000. The firm does not have a Partnership Deed. Will Pratibha get interest on the loan? If yes, at which rate and why?
14. Neha, a partner, owns a building in which the firm carries its business. The firm pays her ₹ 10,000 as rent of the building. To which account rent will be debited?
15. What is meant by 'Fixed Capital' of a Partner? *(Delhi 2016 C)*
16. What is meant by 'Fluctuating Capital' of a Partner? *(AI 2016 C)*
17. Distinguish between 'Fixed Capital Account' and 'Fluctuating Capital Account' on the basis of credit balance. *(AI 2017, CBSE 2019)*
18. A firm maintains a Capital Account and a Current Account for each partner. What is the term used when this method of maintaining Capital Accounts is followed?
19. Give **two** items which may appear in the debit side of a Partner's Current Account. *(Delhi 2018 C)*
20. State the **two** methods of maintaining Capital Accounts of partners.
21. State the **two** situations under which interest on capital is generally provided. *(CBSE 2019)*
22. Interest on capital is credited to Partner's Current Account. Name the method of maintaining Capital Account.
23. Under which Capital Account Method, Current Accounts of partners are maintained?
24. Under which Capital Account Method, Current Accounts of partners are not maintained?
25. Give **four** items that may appear in the credit side of the Partner's Current Account.
26. Give **three** items that may appear in the debit side of the Partner's Current Account.
27. M/s RSA maintains Partners' Capital Accounts under Fixed Capital Accounts Method. Accountant of the firm has credited their salary and interest on capital to their Capital Accounts. Do you agree with the treatment? Give reasons for your answer.
28. Give **two** circumstances in which the Fixed Capitals of partners may change. *(AI, Delhi and Foreign 2009)*
29. List the item that may appear in the debit side of a Partner's Fixed Capital Account.
30. *ABC*, a partnership firm, does not have a Partnership Deed. The firm wants to pay remuneration to the partners. How can it do so?
31. If the Partnership Deed does not specify the profit-sharing ratio, in what ratio is the profit or loss shared by the partners?
32. What share of profit would a sleeping partner who has contributed 75% of the total capital get in the absence of a deed? *(Delhi 2011 C)*
33. If the Partnership Deed does not specify the rate of interest payable on loan by a partner, at what rate will the interest be paid? If not, why?

34. State the provisions of Indian Partnership Act regarding the payment of remuneration to a partner for the services rendered. *(Delhi 2012, AI 2012 C)*

35. If the Partnership Deed does not specify the rate of interest chargeable on drawings, will the interest still be charged? If yes, at what rate? If not, why?

36. State the provisions of Partnership Act, 1932, in the absence of a Partnership Deed regarding (i) Interest on Partner's Drawings, and (ii) Interest on Advances other than capital. *(Foreign 2011)*

37. Can a partner be exempted from sharing losses in a firm? If yes, under what circumstances? *(Delhi 2009)*

38. *A* and *B* are partners in a firm without a Partnership Deed. *A* is an active partner and claims a salary of ₹18,000 per month. State with reason whether the claim is valid or not. *(Delhi 2008)*

39. Raj and Seema started a partnership firm on 1st July, 2018. They agreed that Seema was entitled to a commission of 10% of the net profit after charging Raj's salary of ₹ 2,500 per quarter and Seema's commission. The net profit before charging Raj's salary and Seema's commission for the year ended 31st March, 2019 was ₹ 2,27,500. Calculate Seema's commission. *(CBSE 2019 C)*

40. State the provisions of Indian Partnership Act,1932 regarding interest on partner's capital and interest on partner's loan when there is no Partnership Deed. *(AI 2010 C)*

41. What is Profit and Loss Appropriation Account?

42. Under what circumstances Average Method of calculating interest on drawings is applied?

43. If a fixed amount is withdrawn on 15th day of every month of a calendar year, for what period will the interest on total amount withdrawn be calculated? *(Foreign 2012)*

44. If *A* draws ₹ 15,000 every month at the end of the month, what will be the interest @ 5% p.a.?

45. Amit, a partner in a partnership firm, withdrew ₹ 7,000 in the beginning of each quarter. For how many months would interest on drawings be charged? *(CBSE Sample Paper 2019)*

46. How will you calculate interest on the drawings of equal amount made on the last day of every month of a calendar year? *(Outside Delhi 2009)*

47. Explain briefly the meaning of guarantee of minimum profit.

48. State **one** difference between Fixed Capital Account and Fluctuating Capital Account of partners. *(AI 2008 C, 2014)*

49. Why is it that the Capital Account of a partner does not show a 'Debit Balance' in spite of regular and consistent losses year after year? *(Foreign 2009)*

50. A Partnership Deed provides for the payment of interest on capital but there was a loss instead of profit during the year 2010–11. At what rate will the interest on capital be allowed? *(AI 2012)*

51. What is meant by 'unlimited liability of a partner'? *(Delhi 2010)*

52. When the partners' capitals are fixed, where will the drawings made by a partner be recorded? *(Delhi 2013)*

53. If the partners' capitals are fixed, where will you record interest charged on drawings? *(AI 2013)*

54. Name the method of calculating Interest on Drawings of the partner if different amounts are withdrawn on different dates. *(Delhi 2012 C)*

55. In the absence of provision in the partnership deed, in which ratio is the deficiency arising out of guarantee of profit to a partner borne by the other partners. *(CBSE 2019)*

Short Answer Type Questions

1. Mention the items that may appear in the credit side of the Capital Account of a Partner when the capitals are fluctuating. *(Delhi 1996)*
2. Mention the items that may appear in the debit side of the Capital Account of a Partner when the capitals are fluctuating.
3. List **any four** items appearing on the Profit and Loss Appropriation Account. *(Delhi 2001)*
4. State **any four** features of a Partnership. *(Foreign 2005)*
5. List **any four** contents of a Partnership Deed. *(Delhi 2004, AI 2009)*
6. Discuss the main provisions of the Indian Partnership Act, 1932 that are relevant to partnership accounts if there is no Partnership Deed. *(NCERT)*
7. Distinguish between Fixed and Fluctuating Capitals. *(Delhi 1994, 1995, 2001 C, AI 2005)*
8. State the **two** situations in which interest on Partners' Capital is generally provided. *(Foreign 2017)*

EXERCISE

Partnership Deed

1. In the absence of Partnership Deed, how are the following matters resolved:
   (a) Salaries of partners,
   (b) Interest on partners' capitals,
   (c) Interest on partner's loan,
   (d) Division of profit,
   (e) Interest on partners' drawings,
   (f) Interest on loan by partner(s), and
   (g) Interest on Loan to partners?
2. Following differences have arisen among *P*, *Q* and *R*. State who is correct in each case:
   (a) *P* used ₹ 20,000 belonging to the firm and earned a profit of ₹ 5,000. *Q* and *R* want the amount to be given to the firm.
   (b) *Q* used ₹ 5,000 belonging to the firm and incurred a loss of ₹ 1,000. He wants the firm to bear the loss.
   (c) *P* and *Q* want to purchase goods from *A* Ltd., *R* does not agree.
   (d) *Q* and *R* want to admit *C* as partner, *P* does not agree.
   (e) *R* had given loan of ₹ 1,00,000 to the firm and demands interest @ 10% p.a. *P* and *Q* do not want to pay the interest.
3. *A*, *B* and *C* are partners in a firm. They do not have a Partnership Deed. At the end of the first year of the business, they faced the following problems:
   (a) *A* wants that interest on capital should be allowed to the partners but *B* and *C* do not agree.
   (b) *B* wants that the partners should be allowed to draw salary but *A* and *C* do not agree.
   (c) *A* and *B* want that *C* should pay interest on loan given to him by the firm but *C* does not agree.
   (d) *A* and *B* having contributed larger amounts of capital, desire that the profits should be distributed in the ratio of their capital contribution but *C* does not agree.

   State how you will settle these disputes if the partners approach you for the purpose.
4. Bose, Sarkar and Chatterjee are partners in a firm and do not have a Partnership Deed Bose introduced further capital of ₹ 2,00,000 on 1st October, 2019. Whereas Chatterjee took a loan of ₹ 50,000 from the firm on 1st October, 2019. Disputes have arisen among them on the following issues:
   (a) Bose demands interest @ 10% p.a. on ₹ 2,00,000 being his extra capital.
   (b) Sarkar desires that his son Deep should be admitted as partner and he will give him half of his share. Bose and Chatterjee do not agree.
   (c) Bose and Sarkar are of the view that Chatterjee should be charged interest on loan from the firm at the lending rate of the banks, which is 12% p.a.

(d) Sarkar has withdrawn ₹ 50,000 from the firm for his personal use. Bose and Chatterjee are of the view that Sarkar should be charged interest @ 10% p.a.

You are required to give solution to each issue of dispute.

5. Harshad and Dhiman are in partnership since 1st April, 2019. No partnership agreement was made. They contributed ₹ 4,00,000 and ₹ 1,00,000 respectively as capitals. In addition, Harshad had given loan of ₹ 1,00,000 to the firm on 1st October, 2019. Due to long illness, Harshad could not participate in business activities from 1st August, 2019 to 30th September, 2019. Profit for the year ended 31st March, 2020 was ₹ 1,80,000. Dispute has arisen between Harshad and Dhiman.

Harshad Claims:

(i) He should be given interest @ 10% per annum on capital and loan;

(ii) Profit should be distributed in the ratio of capital;

Dhiman Claims:

(i) Profits should be distributed equally;

(ii) He should be allowed ₹ 2,000 p.m. as remuneration for the period he managed the business in the absence of Harshad;

(iii) Interest on Capital and loan should be allowed @ 6% p.a.

You are required to settle the dispute between Harshad and Dhiman. Also prepare Profit and Loss Appropriation Account. *(NCERT, Modified)*

6. *A* and *B* are partners since 1st April, 2019, without a Partnership Deed and they introduced capitals of ₹ 35,000 and ₹ 20,000 respectively. On 1st October, 2019, *A* gave loan of ₹ 8,000 to the firm without any agreement as to interest. Profit and Loss Account for the year ended 31st March, 2020 shows a profit of ₹ 15,000 but the partners cannot agree on payment of interest and on the basis of division of profit.

You are required to divide the profits between them giving reasons for your method.

Interest on Partner's Loan to the Firm

7. *A* and *B* are partners in a firm sharing profits in the ratio of 3 : 2. They had given loan to the firm of ₹ 30,000 in their profit-sharing ratio on 1st October, 2019. The Partnership Deed is silent on interest on loans from partners. Compute interest payable by the firm to the partners, assuming the firm closes its books every year on 31st March.

8. *X* and *Y* are partners sharing profits and losses in the ratio of 2 : 3 with capitals of ₹ 2,00,000 and ₹ 3,00,000 respectively. On 1st October, 2019, *X* and *Y* gave loans of ₹ 80,000 and ₹ 40,000 respectively to the firm. Show distribution of profits/losses for the year ended 31st March, 2020 in each of the following alternative cases:

Case 1. If the profits before interest for the year amounted to ₹ 21,000.

Case 2. If the profits before interest for the year amounted to ₹ 3,000.

Case 3. If the profits before interest for the year amounted to ₹ 5,000.

Case 4. If the loss before interest for the year amounted to ₹ 1,400.

9. Bat and Ball are partners sharing the profits in the ratio of 2 : 3 with capitals of ₹ 1,20,000 and ₹ 60,000 respectively. On 1st October, 2019, Bat and Ball gave loans of ₹ 2,40,000 and ₹ 1,20,000 respectively to the firm. Bat had allowed the firm to use his property for business for a monthly rent of ₹ 5,000. Loss for the year ended 31st March, 2020 before rent and interest amounted to ₹ 9,000. Show distribution of profit/loss.

10. Akhil and Bimal are partners sharing profits in the ratio of 3 : 2. Akhil gave loan to the firm of ₹ 1,00,000 on 1st October, 2019. On the same date, the firm gave loan to Bimal of ₹ 1,00,000. They do not have an agreement as to interest.

Akhil had also given his personal property for firm's godown at a monthly rent of ₹ 5,000.

Firm earns profit of ₹ 1,03,000 (before above adjustments) for the year ended 31st March, 2020. Show the distribution of profit for the year.

11. Ankit, Bhanu and Charu are partners in a firm sharing profits and losses equally with capital of ₹ 2,50,000 each. On 1st October, 2019, Ankit and Bhanu gave loans of ₹ 2,50,000 each to the firm whereas Charu took a loan of ₹ 1,00,000 from the firm on the same date. It was agreed among the partners that Charu will be charged Interest @ 6% p.a. Interest on loan from partners was paid on 10th April, 2020. The firm closes its books on 31st March each year.

Pass the Journal entries in the books of the firm for the year ended 31st March, 2020.

12. Nirmal and Pawan are partners sharing profits in the ratio of 3 : 2. The firm had given loan to Pawan of ₹ 5,00,000 on 1st April, 2019. Interest was to be charged @ 10% p.a. The firm took loan of ₹ 2,00,000 from Nirmal on 1st October, 2019. Before giving effect to the above, the firm incurred a loss of ₹ 10,000 for the year ended 31st March, 2020.

Determine the amount to be transferred to Profit and Loss Appropriation Account.

Profit and Loss Appropriation Account

13. *A* and *B* are partners. *A*'s Capital is ₹ 1,00,000 and *B*'s Capital is ₹ 60,000. Interest on capital is payable @ 6% p.a. *B* is to get salary of ₹ 3,000 per month. Net Profit for the year is ₹ 80,000.

Prepare Profit and Loss Appropriation Account.

14. *X*, *Y* and *Z* are partners in a firm sharing profits in the ratio of 2 : 2 : 1. Fixed capitals of the partners were: *X* ₹ 5,00,000; *Y* ₹ 5,00,000 and *Z* ₹ 2,50,000 respectively. The Partnership Deed provides that interest on capital is to be allowed @ 10% p.a. *Z* is to be allowed a salary of ₹ 2,000 per month. Profit of the firm for the year ended 31st March, 2020 after debiting *Z*'s salary was ₹ 4,00,000.

Prepare Profit and Loss Appropriation Account.

15. *X* and *Y* are partners sharing profits in the ratio of 3 : 2 with capitals of ₹ 8,00,000 and ₹ 6,00,000 respectively. Interest on capital is agreed @ 5% p.a. *Y* is to be allowed an annual salary of ₹ 60,000 which has not been withdrawn. Profit for the year ended 31st March, 2020 before interest on capital but after charging *Y*'s salary was ₹ 2,40,000.

A provision of 5% of the net profit is to be made in respect of commission to the Manager.

Prepare Profit and Loss Appropriation Account showing the allocation of profits.

16. Prem and Manoj are partners in a firm sharing profits in the ratio of 3 : 2. The Partnership Deed provided that Prem was to be paid salary of ₹ 2,500 per month and Manoj was to get a commission of ₹ 10,000 per year. Interest on capital was to be allowed @ 5% p.a. and interest on drawings was to be charged @ 6% p.a. Interest on Prem's drawings was ₹ 1,250 and on Manoj's drawings was ₹ 425. Interest on Capitals of the partners were ₹ 10,000 and ₹ 7,500 respectively. The firm's net profit for the year ended 31st March, 2020 was ₹ 90,575.

Prepare Profit and Loss Appropriation Account of the firm.

17. Atul and Mithun are partners sharing profits in the ratio of 3 : 2.

Balances as on 1st April, 2019 were as follows:

Capital Accounts (Fixed): Atul—₹ 5,00,000 and Mithun—₹ 6,00,000.

Loan Accounts: Atul—₹ 3,00,000 (Cr.) and Mithun—₹ 2,00,000 (Dr.)

It was agreed to allow and charge interest @ 8% p.a. Partnership Deed provided to allow interest on capital @ 10% p.a. Interest on Drawings was charged ₹ 5,000 each.

Profit before giving effect to above was ₹ 2,28,000 for the year ended 31st March, 2020.

Prepare Profit and Loss Appropriation Account.

18. Reema and Seema are partners sharing profits equally. The Partnership Deed provides that both Reema and Seema will get monthly salary of ₹ 15,000 each, Interest on Capital will be allowed @ 5% p.a. and Interest on Drawings will be charged @ 10% p.a. Their capitals were ₹ 5,00,000 each and drawings during the year were ₹ 60,000 each.

The firm incurred net loss of ₹ 1,00,000 during the year ended 31st March, 2020.

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

19. Bhanu and Partap are partners sharings profits equally. Their fixed capitals as on 1st April, 2019 are ₹ 8,00,000 and ₹ 10,00,000 respectively. Their drawings during the year were ₹ 50,000 and ₹ 1,00,000 respectively. Interest on Capital is a charge and is to be allowed @ 10% p.a. and interest on drawings is to be charged @ 15% p.a. Net Profit for the year ended 31st March, 2020 was ₹ 1,20,000.

Prepare Profit and Loss Appropriation Account.

Partners' Capital Accounts

Fixed Capital

20. Amar and Bimal entered into partnership on 1st April, 2019 contributing ₹ 1,50,000 and ₹ 2,50,000 respectively towards capitals. The Partnership Deed provided for interest on capitals @ 10% p.a. It also provided that Capital Accounts shall be maintained following Fixed Capital Accounts Method. The firm earned net profit of ₹ 1,00,000 for the year ended 31st March, 2020.

Pass the Journal entry for interest on capital.

21. Kamal and Kapil are partners having fixed capitals of ₹ 5,00,000 each as on 31st March, 2019. Kamal introduced further captial of ₹ 1,00,000 on Ist October, 2019 whereas Kapil withdrew ₹ 1,00,000 on 1st October, 2019 out of capital.

Interest on capital is to be allowed @ 10% p.a.

The firm earned net profit of ₹ 6,00,000 for the year ended 31st March, 2020.

Pass the Journal entry for interest on capital and prepare Profit and Loss Appropriation Account.

22. Simran and Reema are partners sharing profits in the ratio of 3 : 2. Their capitals as on 31st March, 2019 were ₹ 2,00,000 each whereas Current Accounts had balances of ₹ 50,000 and ₹ 25,000 respectively. Interest on capital is to be allowed @ 5% p.a. The firm earned net profit of ₹ 3,00,000 for the year ended 31st March, 2020.

Pass the Journal entries for interest on capital and distribution of profit. Also prepare Profit and Loss Appropriation Account for the year.

Fluctuating Capital

23. Anita and Ankita are partners sharing profits equally. Their capitals, maintained following Fluctuating Capital Accounts Method, as on 31st March, 2019 were ₹ 5,00,000 and ₹ 4,00,000 respectively. Partnership Deed provided to allow interest on capital @ 10% p.a. The firm earned net profit of ₹ 2,00,000 for the year ended 31st March, 2020.

Pass the Journal entry for interest on capital.

24. Ashish and Aakash are partners sharing profits in the ratio of 3 : 2. Their Capital Accounts had credit balances of ₹ 5,00,000 and ₹ 6,00,000 respectively as on 31st March, 2020 after debit of drawings during the year of ₹ 1,50,000 and ₹ 1,00,000 respectively. Net profit for the year ended 31st March, 2020 was ₹ 5,00,000.

Interest on capital is to be allowed @ 10% p.a.

Pass the Journal entry for interest on capital and prepare Profit and Loss Appropriation Account.

25. Naresh and Sukesh are partners with capitals of ₹ 3,00,000 each as on 31st March, 2020. Naresh had withdrawn ₹ 50,000 against capital on 1st October, 2019 and ₹ 1,00,000 drawings against profit. Sukesh also had drawings of ₹ 1,00,000.

Interest on capital is to be allowed @ 10% p.a.

Net profit for the year was ₹ 2,00,000, which is yet to be distributed.

Pass the Journal entries for interest on capital and distribution of profit.

26. On 1st April, 2013, Jay and Vijay entered into partnership for supplying laboratory equipments to government schools situated in remote and backward areas. They contributed capitals of ₹ 80,000 and ₹ 50,000 respectively and agreed to share the profits in the ratio of 3 : 2. The Partnership Deed provided that interest on capital shall be allowed at 9% per annum. During the year the firm earned a profit of ₹ 7,800.

Showing your calculations clearly, prepare 'Profit and Loss Appropriation Account' of Jay and Vijay for the year ended 31st March, 2014. *(Delhi 2015)*

Calculation of Interest on Partners' Capitals

27. Following is the extract of the Balance Sheet of Neelkant and Mahadev as on 31st March, 2020:

BALANCE SHEET *as at 31st March, 2020*

Liabilities	₹	Assets	₹
Neelkant's Capital	10,00,000	Sundry Assets	30,00,000
Mahadev's Capital	10,00,000		
Neelkant's Current A/c	1,00,000		
Mahadev' Current A/c	1,00,000		
Profit and Loss A/c (2019–20)	8,00,000		
	30,00,000		30,00,000

During the year, Mahadev's drawings were ₹ 30,000. Profits during the year ended 31st March, 2020 is ₹ 10,00,000. Calculate interest on capital @ 5% p.a. for the year ending 31st March, 2020. *(NCERT, Modified)*

28. From the following Balance Sheet of Long and Short, calculate interest on capital @ 8% p.a. for the year ended 31st March, 2020:

BALANCE SHEET *as at 31st March, 2020*

Liabilities	₹	Assets	₹
Long's Capital A/c	1,20,000	Fixed Assets	3,00,000
Short's Capital A/c	1,40,000	Other Assets	60,000
General Reserve	1,00,000		
	3,60,000		3,60,000

During the year, Long withdrew ₹ 40,000 and Short withdrew ₹ 50,000. Profit for the year was ₹ 1,50,000 out of which ₹ 1,00,000 was transferred to General Reserve.

29. Moli and Bholi contribute ₹ 20,000 and ₹ 10,000 respectively towards capital. They decide to allow interest on capital @ 6% p.a. Their respective share of profits is 2 : 3 and the net profit for the year is ₹ 1,500. Show distribution of profits:

(i) When there is no agreement except for interest on capitals; and

(ii) When there is an agreement that the interest on capital as a charge.

30. Amit and Bramit started business on 1st April, 2019 with capitals of ₹ 15,00,000 and ₹ 9,00,000 respectively. On 1st October, 2019, they decided that their capitals should be ₹ 12,00,000 each. The necessary adjustments in capitals were made by introducing or withdrawing by cheque. Interest on capital is allowed @ 8% p.a. Compute interest on capital for the year ended 31st March, 2020.

Salary or Commission to Partners

31. Amar, Bhanu, and Charu are partners in a firm. Amar and Bhanu are to get annual salary of ₹ 1,20,000 p.a. each as they manage the business. Net profit for the year is ₹ 4,80,000. Determine the share of profit to be credited to each partner.

32. *A, B* and *C* are partners sharing profits and losses in the ratio of 2 : 2 : 1. *A* is entitled to a commission of 10% on the net profit. Net profit for the year is ₹ 1,10,000.

Determine the amount of commission payable to *A*.

33. *X, Y* and *Z* are partners sharing profits and losses equally. As per Partnership Deed, *Z* is entitled to a commission of 10% on the net profit after charging such commission. The net profit before charging commission is ₹ 2,20,000.

Determine the amount of commission payable to *Z*.

34. *A, B, C* and *D* are partners in a firm sharing profits in the ratio of 4 : 3 : 2 : 1. It earned net profit of ₹ 1,80,000 for the year ended 31st March, 2020. As per the Partnership Deed, they are to charge a commission @ 20% of the profit after charging such commission which they will share as 2 : 3 : 2 : 3.

You are required to show appropriation of profits among the partners.

35. *X* and *Y* are partners in a firm. *X* is entitled to a salary of ₹ 10,000 per month and commission of 10% of the net profit after partners' salaries but before charging commission. *Y* is entitled to a salary of ₹ 25,000 p.a. and commission of 10% of the net profit after charging all commission and partners' salaries. Net profit before providing for partners' salaries and commission for the year ended 31st March, 2019 was ₹ 4,20,000. Show distribution of profit.

Calculation of Interest on Partners' Drawings

36. Ram and Mohan, two partners, drew for their personal use ₹ 1,20,000 and ₹ 80,000. Interest is chargeable @ 6% p.a. on the drawings. What is the amount of interest chargeable from each partner?

37. Brij and Mohan are partners in a firm. They withdrew ₹ 48,000 and ₹ 36,000 respectively during the year evenly in the middle of every month. According to the Partnership Deed, interest on drawings is to be charged @ 10% p.a.

Calculate interest on drawings of the partners using the appropriate formula.

38. Dev withdrew ₹ 10,000 on 15th day of every month. Interest on drawings was to be charged @ 12% per annum. Calculate interest on Dev's Drawings. (*CBSE 2019*)

39. *A* and *B* are partners sharing profits equally. *A* drew regularly ₹ 4,000 in the beginning of every month for six months ended 30th September, 2019. Calculate interest on drawings @ 5% p.a. for a period of six months.

40. One of the partners in a partnership firm has withdrawn ₹ 9,000 at the end of each quarter, throughout the year. Calculate interest on drawings at the rate of 6% per annum. (*CBSE Sample Question Paper 2018*)

41. *A* and *B* are partners sharing profits equally. *A* drew regularly ₹ 4,000 at the end of every month for six months ended 30th September, 2019. Calculate interest on drawings @ 5% p.a. for a period of six months.

42. Calculate interest on drawings of Ashok @ 10% p.a. for the year ended 31st March, 2020, in each of the following alternative cases:

Case 1. If he withdrew ₹ 7,500 in the beginning of each quarter.

Case 2. If he withdrew ₹ 7,500 at the end of each quarter.

Case 3. If he withdrew ₹ 7,500 during the middle of each quarter.

43. Kanika and Gautam are partners doing a dry cleaning business in Lucknow, sharing profits in the ratio 2 : 1 with capitals ₹ 5,00,000 and ₹ 4,00,000 respectively. Kanika withdrew the following amounts during the year to pay the hostel expenses of her son:

1st April	₹ 10,000
1st June	₹ 9,000
1st November	₹ 14,000
1st December	₹ 5,000

Gautam withdrew ₹ 15,000 on the first day of April, July, October and January to pay rent for the accommodation of his family. He also paid ₹ 20,000 per month as rent for the office of partnership which was in a nearby shopping complex.

Calculate interest on drawings @ 6% p.a. *(CBSE Sample Paper 2015)*

Profit and Loss Appropriation Account and Partners' Capital Accounts

44. *C* and *D* are partners in a firm; *C* has contributed ₹ 1,00,000 and *D* ₹ 60,000 as capitals. Interest is payable @ 6% p.a. and *D* is entitled to salary of ₹ 3,000 per month. In the year ended 31st March, 2020, the profit was ₹ 80,000 before interest and salary.

Prepare Profit and Loss Appropriation Account.

45. Amit and Vijay started a partnership business on 1st April, 2019. Their capital contributions were ₹ 2,00,000 and ₹ 1,50,000 respectively. The Partnership Deed provided as follows:

(a) Interest on capital be allowed @ 10% p.a.

(b) Amit to get a salary of ₹ 2,000 per month and Vijay ₹ 3,000 per month.

(c) Profits are to be shared in the ratio of 3 : 2.

Net Profit for the year ended 31st March, 2020 was ₹ 2,16,000. Interest on drawings amounted to ₹ 2,200 for Amit and ₹ 2,500 for Vijay.

Prepare Profit and Loss Appropriation Account.

46. Prepare Capital Accounts of the Partners Sohan and Mohan from the following information, if their capitals are fluctuating:

	Sohan (₹)	*Mohan (₹)*
Capitals on 1st April, 2019	4,00,000	3,00,000
Drawings during the year ended 31st March, 2020	50,000	30,000
Interest on Capital	5% p.a.	5% p.a.
Interest on Drawings	1,250	750
Share of Profit for the year ended 31st March, 2020	60,000	50,000
Partner's Salary	36,000	...
Commission	5,000	3,000

47. *A* and *B* are partners sharing profits and losses in the ratio of 3 : 1. On 1st April, 2019, their capitals were: *A* ₹ 50,000 and *B* ₹ 30,000. During the year ended 31st March, 2020, the firm earned a net profit of ₹ 50,000. The terms of partnership are:

(a) Interest on capital is to be allowed @ 6% p.a.

(b) *A* will get a commission @ 2% on turnover.

(c) *B* will get a salary of ₹ 500 per month.

(d) *B* will get commission of 5% on profits after deduction of all expenses including such commission.

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

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

48. Sajal and Kajal are partners sharing profits and losses in the ratio of 2 : 1. On 1st April, 2019 their Capitals were: Sajal—₹ 5,00,000 and Kajal—₹ 4,00,000.

Prepare Profit and Loss Appropriation Account and the Partners' Capital Accounts at the end of the year from the following information:

(a) Interest on Capital is to be allowed @ 5% p.a.

(b) Interest on the loan advanced by Kajal for the whole year, the amount of loan being ₹ 3,00,000.

(c) Interest on partners' drawings @ 6% p.a. Drawings: Sajal ₹ 1,00,000 and Kajal ₹ 80,000.

(d) 10% of the divisible profit is to be transferred to General Reserve.

Profit, before giving effect to the above, for the year ended 31st March, 2020 is ₹ 7,02,600.

Note: Net profit means net profit after debit of interest on loan by the partner.

49. Ali and Bahadur are partners in a firm sharing profits and losses as Ali 70% and Bahadur 30%. Their respective capitals as at 1st April, 2019 stand as Ali ₹ 25,000 and Bahadur ₹ 20,000. The partners are allowed interest on capitals @ 5% p.a. Drawings of the partners during the year ended 31st March, 2020 were ₹ 3,500 and ₹ 2,500 respectively.

Profit for the year, before allowing interest on capital and annual salary of Bahadur @ ₹ 3,000, was ₹ 40,000, 10% of divisible profit is to be transferred to Reserve.

Prepare Partners' Current Accounts and Capital Accounts recording the above transactions.

50. *A* and *B* are partners sharing profits in the ratio of 3 : 2 with capitals of ₹ 50,000 and ₹ 30,000 respectively. Interest on capital is agreed @ 6% p.a. *B* is to be allowed an annual salary of ₹ 2,500. *A* provision of 5% of net profit is to be made in respect of Manager's Commission and rent of ₹ 24,000 is to be accounted being payable to *A*. Profit for the year before manager's commission and rent to *A* was ₹ 39,000.

Prepare Profit and Loss Appropriation account and the Partners' Capital Accounts.

51. *A*, *B* and *C* were partners in a firm having capitals of ₹ 50,000; ₹ 50,000 and ₹ 1,00,000 respectively. Their Current Account balances were *A*: ₹ 10,000; *B*: ₹ 5,000 and *C*: ₹ 2,000 (Dr.). According to the Partnership Deed the partners were entitled to an interest on Capital @ 10% p.a. *C* being the working partner was also entitled to a salary of ₹ 12,000 p.a. The profits were to be divided as:

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

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

(c) Remaining profits to be shared equally.

The firm earned net profit of ₹ 1,72,000 before charging any of the above items.

Prepare Profit and Loss Appropriation Account and pass necessary Journal entry for the appropriation of profits. (*Foreign 2009*)

52. *A*, *B* and *C* are partners sharing profits and losses in the ratio of *A* 1/2, *B* 3/10, *C* 1/5 after providing for interest @ 5% on their respective capitals, *viz.*, *A* ₹ 50,000; *B* ₹ 30,000 and *C* ₹ 20,000 and allowing *B* and *C* salary of ₹ 5,000 each per annum. During the year ended 31st March, 2020, *A* has drawn ₹ 10,000 and *B* and *C* in addition to their salaries have drawn ₹ 2,500 and ₹ 1,000 respectively. Profit and Loss Account for the year ended 31st March, 2020 showed net profit of ₹ 45,000. On 1st April, 2019, the balances in the Current Accounts of the partners were *A* (Cr.) ₹ 4,500; *B* (Cr.) ₹ 1,500 and *C* (Cr.) ₹ 1,000. Interest is not charged on Drawings and allowed on Current Account balances. Show Partners' Capital and Current Accounts as at 31st March, 2020 after division of profits in accordance with the partnership agreement.

53. Amit, Binita and Charu are three partners. On 1st April, 2019, their Capitals stood as: Amit ₹ 1,00,000, Binita ₹ 2,00,000 and Charu ₹ 3,00,000. It was decided that:

(a) they would receive interest on Capitals @ 5% p.a.,

(b) Amit would get a salary of ₹ 10,000 per month,

(c) Binita would receive commission @ 5% of net profit after deduction of commission, and

(d) 10% of the net profit would be transferred to the General Reserve.

Before the above items were taken into account, profit for the year ended 31st March, 2020 was ₹ 5,00,000. Prepare Profit and Loss Appropriation Account and the Capital Accounts of the Partners.

54. Anshul and Asha are partners sharing profits and losses in the ratio of 3 : 2. Anshul being a non-working partner contributed ₹ 8,00,000 as her capital. Asha being a working partner did not contribute capital. The Partnership Deed provides for interest on capital @ 5% and salary to every working partner @ ₹ 2,000 per month. Net profit (before providing for interest on capital and partner's salary) for the year ended 31st March, 2020 was ₹ 32,000.

Show distribution of profits.

55. Kabir, Zoravar and Parul are partners sharing profits in the ratio of 5 : 3 : 2. Their capitals as on 1st April, 2019 were: Kabir—₹ 5,20,000, Zoravar—₹ 3,20,000 and Parul—₹ 2,00,000.

The Partnership Deed provided as follows:

(i) Kabir and Zoravar each will get salary of ₹ 24,000 p.a.

(ii) Parul will get commission of 2% of Sales.

(iii) Interest on capital is to be allowed @ 5% p.a.

(iv) Interest on Drawings is to be charged @ 5% p.a.

(v) 10% of Divisible Profit is to be transferred to General Reserve.

Sales for the year ended 31st March, 2020 were ₹ 50,00,000. Drawings by each of the partners during the year was ₹ 60,000. Net Profit for the year was ₹ 1,55,500.

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

56. *X* and *Y* entered into partnership on 1st April, 2017. Their capitals as on 1st April, 2019 were ₹ 2,00,000 and ₹ 1,50,000 respectively. On 1st October, 2019, *X* gave ₹ 50,000 as loan to the firm. As per the provisions of the Partnership Deed:

(i) 20% of Profits before charging Interest on Drawings but after making appropriations was to be transferred to General Reserve.

(ii) Interest on capital is to be allowed @ 12% p.a. and Interest on Drawings is to be charged @ 10% p.a.

(iii) *X* to get monthly salary of ₹ 5,000 and *Y* to get salary of ₹ 22,500 per quarter.

(iv) *X* is entitled to a commission of 5% on sales. Sales for the year were ₹ 3,50,000.

(v) Profit to be shared in the ratio of their capitals up to ₹ 1,75,000 and balance equally.

Profit for the year ended 31st March, 2020, before allowing or charging interest was ₹ 4,61,000. The drawings of *X* and *Y* were ₹ 1,00,000 and ₹ 1,25,000 respectively.

Pass the necessary Journal entries relating to appropriation of profit. Prepare Profit and Loss Appropriation Account and the Partners' Capital Accounts.

Adjustments for Incorrect Appropriations in the Past (Past Adjustments)

57. Reya, Mona and Nisha shared profits in the ratio of 3 : 2 : 1. Profits for the last three years were ₹ 1,40,000; ₹ 84,000 and ₹ 1,06,000 respectively. These profits were by mistake distributed equally. The error is now to be corrected.

Give the necessary rectification Journal entry.

58. *P* and *Q* were partners in a firm sharing profits and losses equally. Their fixed capitals were ₹ 2,00,000 and ₹ 3,00,000 respectively. The Partnership Deed provided for interest on capital @ 12% per annum. For the year ended 31st March, 2016, profits of the firm were distributed without providing interest on capital.

Pass necessary adjustment entry to rectify the error. (*Outside Delhi 2017*)

59. Azad and Benny are equal partners. Their capitals are ₹ 40,000 and ₹ 80,000 respectively. After the accounts for the year had been prepared, it was noticed that interest @ 5% p.a. as provided in the Partnership Deed was not credited to their Capital Accounts before distribution of profits. It is decided to pass an adjustment entry in the beginning of the next year. Record the necessary Journal entry.

60. Ram, Mohan and Sohan sharing profits and losses equally have capitals of ₹ 1,20,000, ₹ 90,000 and ₹ 60,000 respectively. For the year ended 31st March, 2020, interest was credited to them @ 6% p.a. instead of 5% p.a. Give adjustment Journal entry.

61. Ram, Shyam and Mohan were partners in a firm sharing profits and losses in the ratio of 2 : 1 : 2. Their capitals were fixed at ₹ 3,00,000, ₹ 1,00,000, ₹ 2,00,000. For the year ended 31st March, 2020, interest on capital was credited to them @ 9% instead of 10% p.a. The profit for the year before charging interest was ₹ 2,50,000. Show your working notes and pass necessary adjustment entry.

62. Simrat and Bir are partners in a firm sharing profits and losses in the ratio of 3 : 2. On 31st March, 2020 after closing the books of account, their Capital Accounts stood at ₹ 4,80,000 and ₹ 6,00,000 respectively. On 1st May, 2019, Simrat introduced an additional capital of ₹ 1,20,000 and Bir withdrew ₹ 60,000 from his capital. On 1st October, 2019, Simrat withdrew ₹ 2,40,000 from her capital and Bir introduced ₹ 3,00,000. Interest on capital is allowed at 6% p.a. Subsequently, it was noticed that interest on capital @ 6% p.a. had been omitted. Profit for the year ended 31st March, 2020 amounted to ₹ 2,40,000 and the partners' drawings had been: Simrat—₹ 1,20,000 and Bir—₹ 60,000.

Compute the interest on capital if the capitals are (a) fixed, and (b) fluctuating.

63. Profit earned by a partnership firm for the year ended 31st March, 2020 were distributed equally between the partners—Pankaj and Anu—without charging interest on Drawings. Interest due on Drawings was Pankaj—₹ 3,000 and Anu—₹ 1,000.

Pass necessary adjustment entry.

64. Mita and Usha are partners in a firm sharing profits in the ratio of 2 : 3. Their Capital Accounts as on 1st April, 2015 showed balances of ₹ 1,40,000 and ₹ 1,20,000 respectively. The drawings of Mita and Usha during the year 2015–16 were ₹ 32,000 and ₹ 24,000 respectively. Both the amounts were withdrawn on 1st January 2016. It was subsequently found that the following items had been omitted while preparing the final accounts for the year ended 31st March, 2016:

(a) Interest on Capital @ 6% p.a.

(b) Interest on Drawings @ 6% p.a.

(c) Mita was entitled to a commission of ₹ 8,000 for the whole year.

Showing your working clearly, pass a rectifying entry in the books of the firm. (*AI 2017 C*)

65. *A*, *B* and *C* were partners. Their fixed capitals were ₹ 60,000, ₹ 40,000 and ₹ 20,000 respectively. Their profit-sharing ratio was 2 : 2 : 1. According to the Partnership Deed, they were entitled to interest on capital @ 5% p.a. In addition, *B* was also entitled to draw a salary of ₹ 1,500 per month. *C* was entitled to a commission of 5% on the profits after charging the interest on capital, but before charging the salary payable to *B*. The net profits for the year, ₹ 80,000, were distributed in the ratio of their capitals without providing for any of the above adjustments. Showing your workings clearly, pass the necessary adjustment entry. (*CBSE 2019*)

66. On 31st March, 2020, after the closing of the accounts, Capital Accounts of *P*, *Q* and *R* stood in the books of the firm at ₹ 40,000; ₹ 30,000 and ₹ 20,000 respectively. Subsequently, it was noticed that interest on capital @ 5% had been omitted. Profit for the year ended 31st March, 2020 was ₹ 60,000 and the partners' drawings had been *P*—₹ 10,000, *Q*—₹ 7,500 and R—₹ 4,500. Profit-sharing ratio of *P*, *Q* and *R* is 3 : 2 : 1.

Pass necessary adjustment entry.

67. Mohan, Vijay and Anil are partners, the balances of their Capital Accounts being ₹ 30,000, ₹ 25,000 and ₹ 20,000 respectively. In arriving at these amounts profit for the year ended 31st March, 2020, ₹ 24,000 had been credited to partners in their profit-sharing ratio. Their drawings were ₹ 5,000 (Mohan), ₹ 4,000 (Vijay) and ₹ 3,000 (Anil) during the year. Subsequently, following omissions were noticed and it was decided to rectify the errors:

(a) Interest on capital @ 10% p.a.

(b) Interest on drawings: Mohan ₹ 250, Vijay ₹ 200 and Anil ₹ 150.

Make necessary corrections through a Journal entry and show your workings clearly.

68. Piya and Bina are partners in a firm sharing profits and losses in the ratio of 3 : 2. Following was the Balance Sheet of the firm as on 31st March, 2016:

Liabilities		₹	Assets	₹
Capitals:			Sundry Assets	1,20,000
Piya	80,000			
Bina	40,000	1,20,000		
		1,20,000		1,20,000

The profits ₹ 30,000 for the year ended 31st March, 2016 were divided between the partners without allowing interest on capital @ 12% p.a. and salary to Piya @ ₹ 1,000 per month. During the year Piya withdrew ₹ 8,000 and Bina withdrew ₹ 4,000. Showing your working notes clearly, pass the necessary rectifying entry. *(Delhi 2017 C)*

69. Naveen, Qadir and Rajesh were partners doing an electronic goods business in Uttarakhand. After the accounts of partnership were drawn up and closed, it was discovered that interest on capital has been allowed to partners @ 6% p.a. for the years ending 31st March, 2017 and 2018, although there is no provision for interest on capital in the Partnership Deed. On the other hand, Naveen and Qadir were entitled to a salary of ₹ 3,500 and ₹ 4,000 per quarter respectively, which has not been taken into consideration. Their fixed capitals were ₹ 4,00,000, ₹ 3,60,000 and ₹ 2,40,000 respectively. During the last two years they had shared the profits and losses as follows:

Year Ended	Ratio
31st March, 2017	3 : 2 : 1
31st March, 2018	5 : 3 : 2

Pass necessary adjusting entry for the above adjustments in the books of the firm on 1st April, 2018. Show your workings clearly. *(CBSE 2019)*

70. Mannu and Shristhi are partners in a firm sharing profits in the ratio of 3 : 2. Following information is of the firm as on 31st March, 2020:

Liabilities		₹	Assets		₹
Mannu's Capital	3,00,000		Drawings:		
Shristhi's Capital	1,00,000	4,00,000	Mannu	40,000	
			Shristhi	20,000	60,000
			Other Assets		3,40,000
		4,00,000			4,00,000

Profit for the year ended 31st March, 2020 was ₹ 50,000 which was divided in the agreed ratio, but interest @ 5% p.a. on capital and @ 6% p.a. on drawings was inadvertently omitted. Adjust interest on drawings on an average basis for 6 months. Give the adjustment entry. *(NCERT, Modified)*

71. Mudit, Sudhir and Uday are partners in a firm sharing profits in the ratio of 3 : 1 : 1. Their fixed capital balances are ₹ 4,00,000, ₹ 1,60,000 and ₹ 1,20,000 respectively. Net profit for the year ended 31st March, 2018 distributed amongst the partners was ₹ 1,00,000, without taking into account the following adjustments:

(a) Interest on capitals @ 2.5% p.a.;

(b) Salary to Mudit ₹ 18,000 p.a. and commission to Uday ₹ 12,000.

(c) Mudit was allowed a commission of 6% of divisible profit after charging such commission.

Pass a rectifying Journal entry in the books of the firm. Show workings clearly. (*CBSE Sample Paper 2019*)

72. *A*, *B* and *C* are partners in a firm. Net profit of the firm for the year ended 31st March, 2020 is ₹ 30,000, which has been duly distributed among the partners in their agreed ratio of 3 : 1 : 1. It is noticed on 10th April, 2020 that the undermentioned transactions were not passed through the books of account of the firm for the year ended 31st March, 2020.

(a) Interest on Capital @ 6% per annum, the capital of *A*, *B* and *C* being ₹ 50,000; ₹ 40,000 and ₹ 30,000 respectively.

(b) Interest on drawings: *A* ₹ 350; *B* ₹ 250; *C* ₹ 150.

(c) Partners' Salaries: *A* ₹ 5,000; *B* ₹ 7,500.

(d) Commission due to *A* (for some special transaction) ₹ 3,000.

You are required to pass a Journal entry, which will not affect Profit and Loss Account of the firm and rectify the position of partners inter se.

73. On 31st March, 2018 the balance in the Capital Accounts of Abhir, Bobby and Vineet, after making adjustments for profits and drawings were ₹ 8,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively.

Subsequently, it was discovered that interest on capital and interest on drawings had been omitted. The partners were entitled to interest on capital @ 10% p.a. and were to be charged interest on drawings @ 6% p.a. The drawings during the year were: Abhir—₹ 20,000 drawn at the end of each month, Bobby—₹ 50,000 drawn at the beginning of every half year and Vineet—₹ 1,00,000 withdrawn on 31st October, 2017. The net profit for the year ended 31st March, 2018 was ₹ 1,50,000. The profit-sharing ratio was 2 : 2 : 1.

Pass necessary adjusting entry for the above adjustments in the books of the firm. Also, show your workings clearly. *(CBSE 2019)*

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

(a) The profit for the year ended 31st March, 2014 was ₹ 80,000.

(b) During the year Saroj and Mahinder each withdrew a sum of ₹ 24,000 in equal instalments in the end of each month and Umar withdrew ₹ 36,000.

(c) The interest on drawings was to be charged @ 5% p.a. and interest on capital was to be allowed @ 10% p.a.

(d) The profit-sharing ratio among partners was 4 : 3 : 1.

Showing your workings clearly, pass the necessary rectifying entry. (*Delhi 2015 C*)

75. Capitals of *A*, *B* and *C* as on 31st March, 2019 amounted to ₹ 90,000, ₹ 3,30,000 and ₹ 6,60,000 respectively. Profit of ₹ 1,80,000 for the year ended 31st March, 2019 was distributed in the ratio of 4 : 1 : 1 after allowing Interest on Capital @ 10% p.a. During the year, each partner withdrew ₹ 3,60,000. The Partnership Deed was silent as to profit-sharing ratio but provided for interest on capital @ 12%.

Pass the necessary adjustment entry showing the working clearly.

76. Capital Accounts of *A* and *B* stood at ₹ 4,00,000 and ₹ 3,00,000 respectively after necessary adjustments in respect of the drawings and the net profit for the year ended 31st March, 2019. It was subsequently noticed that 5% p.a. interest on capital and also drawings were not taken into account in arriving at the distributable profit. The drawings of the partners had been: *A*—₹ 12,000 drawn at the end of each quarter and *B*—₹ 18,000 drawn at the end of each half year.

The profit for the year as adjusted amounted to ₹ 2,00,000. The partners share profits in the ratio of 3 : 2.

You are required to pass Journal entries and show adjusted Capital Accounts of the partners.

77. The firm of Harry, Porter and Ali, who have been sharing profits in the ratio of 2 : 2 : 1, have existed for some years. Ali wants that he should get equal share in the profits with Harry and Porter and he further wishes that the change in the profit-sharing ratio should come into effect retrospectively for the three years. Harry and Porter have agreed to it. Profits for the last three years ended 31st March, were:

Year ended 31st March,	2018	2019	2020
Profit (₹)	2,20,000	2,40,000	2,90,000

Show adjustment of profits by means of an adjustment Journal entry. *(NCERT, Modified)*

Guarantee of Profit to a Partner

78. *A* and *B* are partners sharing profits in the ratio of 3 : 2. *C* was admitted for 1/6th share of profit with a minimum guaranteed amount of ₹ 10,000. At the close of the first financial year the firm earned a profit of ₹ 54,000. Find out the share of profit which *A*, *B* and *C* will get.

79. *A*, *B* and *C* were in partnership sharing profits and losses in the ratio of 4 : 2 : 1. It was provided that *C*'s share in profit for a year would not be less than ₹ 75,000. Profit for the year ended 31st March, 2020 amounted to ₹ 3,15,000. You are required to show the appropriation among the partners. The Profit and Loss Appropriation Account is not required.

80. *X*, *Y* and *Z* entered into partnership on 1st October, 2019 to share profits in the ratio of 4 : 3 : 3. *X*, personally guaranteed that *Z*'s share of profit after charging interest on capital @ 10% p.a. would not be less than ₹ 80,000 in a year. Capital contributions were: *X*—₹ 3,00,000, *Y*—₹ 2,00,000 and *Z*—₹ 1,50,000.

Profit for the year ended 31st March, 2020 was ₹ 1,60,000. Prepare Profit and Loss Appropriation Account.

81. *A*, *B* and *C* are partners in a firm. Their profit-sharing ratio is 2 : 2 : 1. *C* is guaranteed a minimum of ₹ 1,00,000 as share of profit every year. Any deficiency arising shall be met by *B*. The profits for the two years ended 31st March, 2019 and 2020 were ₹ 4,00,000 and ₹ 6,00,000 respectively.

Prepare Profit and Loss Appropriation Account for the two years.

82. *A*, *B* and *C* are partners sharing profits in the ratio of 5 : 4 : 1. *C* is given a guarantee that his minimum share of profit in any given year would be at least ₹ 5,000. Deficiency, if any, would be borne by *A* and *B* equally. Profit for the year ended 31st March, 2020 was ₹ 40,000.

Pass necessary Journal entries in the books of the firm.

83. Vikas and Vivek were partners in a firm sharing profits in the ratio of 3 : 2. On 1st April, 2019, they admitted Vandana as a new partner for 1/8th share in the profits with a guaranteed profit of ₹ 1,50,000. New profit-sharing ratio between Vikas and Vivek will remain same but they decided to bear any deficiency on account of guarantee to Vandana in the ratio 3 : 2. Profit of the firm for the year ended 31st March, 2020 was ₹ 9,00,000.

Prepare Profit and Loss Appropriation Account of Vikas, Vivek and Vandana for the year ended 31st March, 2020. *(AI 2016, Modified)*

84. *A*, *B* and *C* are partners in a firm sharing profits in the ratio of 3 : 2 : 1. They earned profit of ₹ 30,000 during the year ended 31st March, 2020. Distribute profit among *A*, *B* and *C* if:

(a) *C*'s share of profit is guaranteed to be ₹ 6,000 minimum.

(b) Minimum profit payable to *C* amounting to ₹ 6,000 is guaranteed by *A*.

(c) Guaranteed minimum profit of ₹ 6,000 payable to *C* is guaranteed by *B*.

(d) Any deficiency after making payment of guaranteed ₹ 6,000 will be borne by *A* and *B* in the ratio of 3 : 1.

85. *A* and *B* are in partnership sharing profits and losses in the ratio of 3 : 2. They admit *C*, their Manager, as a partner with effect from 1st April, 2020, for 1/4th share of profits.

C, while a Manager, was in receipt of a salary of ₹ 27,000 p.a. and a commission of 10% of net profit after charging such salary and commission.

In terms of the Partnership Deed, any excess amount, which *C* will be entitled to receive as a partner over the amount which would have been due to him if he continued to be the Manager, will be borne by *A*. Profit for the year ended 31st March, 2020 amounted to ₹ 2,25,000.

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

86. *P*, *Q* and *R* entered into partnership on 1st April, 2015 to share profits and losses in the ratio of 12 : 8 : 5. It was provided that in no case *R*'s share in profit be less than ₹ 30,000 p.a. The profits and losses for the year ended 31st March, were: 2018 Profit ₹ 1,20,000; 2019 Profit ₹ 1,80,000; 2020 Loss ₹ 1,20,000.

Pass the necessary Journal entries in the books of the firm.

87. Asgar, Chaman and Dholu are partners in a firm. Their Capital Accounts stood at ₹ 6,00,000; ₹ 5,00,000 and ₹ 4,00,000 respectively on 1st April, 2019. They shared Profits and Losses in the proportion of 4 : 2 : 3. Partners are entitled to interest on capital @ 8% per annum and salary to Chaman and Dholu @ ₹ 7,000 per month and ₹ 10,000 per quarter respectively as per the provision of the Partnership Deed.

Dholu's share of profit (excluding interest on capital but including salary) is guaranteed at a minimum of ₹ 1,10,000 p.a. Any deficiency arising on that account shall be met by Asgar. The profit for the year ended 31st March, 2020 amounted to ₹ 4,24,000.

Prepare Profit and Loss Appropriation Account for the year ended 31st March, 2020. *(Delhi 2013, Modified)*

88. Ankur, Bhavna and Disha are partners in a firm. On 1st April, 2019, the balances in their Capital Accounts stood at ₹ 14,00,000, ₹ 6,00,000 and ₹ 4,00,000 respectively. They shared profits in the proportion of 7 : 3 : 2 respectively. Partners are entitled to interest on capital @ 6% per annum and salary to Bhavna @ ₹ 50,000 p.a. and a commission of ₹ 3,000 per month to Disha as per the provisions of the Partnership Deed.

Bhavna's share of profit (excluding interest on capital) is guaranteed at not less than ₹ 1,70,000 p.a. Disha's share of profit (including interest on capital but excluding commission) is guaranteed at not less than ₹ 1,50,000 p.a. Any deficiency arising on that account shall be met by Ankur. The profit of the firm for the year ended 31st March, 2020 amounted to ₹ 9,50,000.

Prepare 'Profit and Loss Appropriation Account' for the year ended 31st March, 2020. *(AI 2013, Modified)*

89. Ajay, Binay and Chetan were partners sharing profits in the ratio of 3 : 3 : 2. The Partnership Deed provided for the following:

(i) Salary of ₹ 2,000 per quarter to Ajay and Binay.

(ii) Chetan was entitled to a commission of ₹ 8,000.

(iii) Binay was guaranteed a profit of ₹ 50,000 p.a.

The profit of the firm for the year ended 31st March, 2015 was ₹ 1,50,000 which was distributed among Ajay, Binay and Chetan in the ratio of 2 : 2 : 1, without taking into consideration the provisions of Partnership Deed. Pass necessary rectifying entry for the above adjustments in the books of the firm. Show your workings clearly. (*Delhi 2016 C*)

90. The partners of a firm, Alia, Bhanu and Chand distributed the profits for the year ended 31st March, 2017, ₹ 80,000 in the ratio of 3 : 3 : 2 without providing for the following adjustments:

(a) Alia and Chand were entitled to a salary of ₹ 1,500 each per month.

(b) Bhanu was entitled for a commission of ₹ 4,000.

(c) Bhanu and Chand had guaranteed a minimum profit of ₹ 35,000 p.a. to Alia any deficiency to borne equally by Bhanu and Chand.

Pass the necessary Journal entry for the above adjustments in the books of the firm. Show workings clearly. (*CBSE Sample Paper 2018*)

Minimum Earnings Guranteed by a Partner

91. Three Chartered Accountants *A, B* and *C* form a partnership, profits being shared in the ratio of 3 : 2 : 1 subject to the following:

(a) *C's* share of profit guaranteed to be not less than ₹ 15,000 p.a.

(b) *B* gives a guarantee to the effect that gross fee earned by him for the firm shall be equal to his average gross fee of the preceeding five years when he was carrying on profession alone, which on an average works out at ₹ 25,000.

The profit for the first year of the partnership are ₹ 75,000. The gross fee earned by *B* for the firm is ₹ 16,000. You are required to show Profit and Loss Appropriation Account after giving effect to the above.

(*NCERT, Modified*)

EVALUATION QUESTIONS: QUESTIONS WITH MISSING VALUES

1 **(Commission to Partners and Distribution of Profit)**. *X* and *Y* are partners in a firm. *X* gets a commission of 10% on the net profits before charging any commission and *Y* gets a commission of 10% on the net profits after charging all commission.

Compute the missing values (?) from the following Profit and Loss Appropriation Account for the year ended 31st March, 2020:

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

Particulars		₹	Particulars	₹
To *X's* Commission A/c		1,65,000	By Profit and Loss A/c (Net Profit)	?
To *Y's* Commission A/c		?		
To Profit transferred to:				
X's Capital A/c	?			
Y's Capital A/c	?	?		
		?		?

Solution:

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

Particulars		₹	Particulars	₹
To *X's* Commission A/c		1,65,000	By Profit and Loss A/c (Net Profit) **(WN 1)**	**16,50,000**
To *Y's* Commission A/c **(WN 2)**		**1,35,000**		
To Profit transferred to:				
X's Capital A/c	**6,75,000**			
Y's Capital A/c	**6,75,000**	**13,50,000**		
		16,50,000		**16,50,000**

Working Notes:

1. *Calculation of Profit before Charging any Commission:*
   X's Commission 10% on the net profit before charging any commission = ₹ 1,65,000
   ∴ Net profit before charging any commission = 1,65,000 ×100/10 = ₹ 16,50,000.
2. *Calculation of Y's Commission:*
   Net Profit after charging *X's* Commission = ₹ 16,50,000 – ₹ 1,65,000 = ₹ 14,85,000
   Y's Commission = ₹ 14,85,000 × 10/110 = ₹ 1,35,000.

2 **(Distribution of Profit).** *X* and *Y* entered into partnership on 1st April, 2019. They do not have Partnership Deed. They contributed capitals of ₹ 10,00,000 and ₹ 6,00,000 respectively. On 31st October, 2019, *X* advanced a loan of ₹ 4,00,000 to the firm without any agreement as to interest. Books are closed on 31st March every year.

Fill the missing information/values (?) in the following Accounts:

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

Particulars	₹	Particulars	₹
To ?	?	By Net Profit	?
To Net Profit transferred to Profit and Loss Appropriation A/c	8,50,000		
	?		?

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

Particulars		₹	Particulars	₹
To *X*'s Capital A/c	?		By Profit and Loss A/c (Net Profit)	?
To *Y*'s Capital A/c	?	?		
		?		?

Dr. PARTNERS' CAPITAL ACCOUNTS *Cr.*

Particulars	*X* (₹)	*Y* (₹)	Particulars	*X* (₹)	*Y* (₹)
To Balance *c/d*	?	?	By Bank A/c	?	?
			By Profit and Loss Appropriation A/c	?	?
	?	?		?	?

Dr. *X*'S LOAN ACCOUNT *Cr.*

Particulars	₹	Particulars	₹
To Balance *c/d*	?	By ?	?
		By ?	?
	?		?

Solution:

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

Particulars	₹	Particulars	₹
To **Interest on *X*'s Loan A/c (₹ 4,00,000 × 5/12 × 6/100)**	**10,000**	By Net Profit	**8,60,000**
To Net Profit transferred to Profit and Loss Appropriation A/c	8,50,000		
	8,60,000		**8,60,000**

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

Particulars		₹	Particulars	₹
To *X*'s Capital A/c **(Profit)**	**4,25,000**		By Profit and Loss A/c (Net Profit)	**8,50,000**
To *Y*'s Capital A/c **(Profit)**	**4,25,000**	**8,50,000**		
		8,50,000		**8,50,000**

Dr. PARTNERS' CAPITAL ACCOUNTS Cr.

Particulars	X (₹)	Y (₹)	Particulars	X (₹)	Y (₹)
To Balance c/d	**14,25,000**	**10,25,000**	By Bank A/c **(Given)**	**10,00,000**	**6,00,000**
			By Profit and Loss Appropriation A/c	**4,25,000**	**4,25,000**
	14,25,000	**10,25,000**		**14,25,000**	**10,25,000**

Dr. X'S LOAN ACCOUNT Cr.

Particulars	₹	Particulars	₹
To Balance c/d	**4,10,000**	By **Bank A/c (Given)**	**4,00,000**
		By **Interest on X's Loan A/c**	**10,000**
	4,10,000		**4,10,000**

Scan QR Code for Additional Questions

Scan QR Code for Key Terms and Chapter Summary

GUIDE TO ANSWERS

Objective Type Questions

1. *State whether the following statements are **True** or **False**:*

(i) False; (ii) True; (iii) False; (iv) False; (v) True; (vi) True; (vii) False; (viii) False; (ix) True; (x) True; (xi) True; (xii) False; (xiii) False; (xiv) True; (xv) False; (xvi) False; (xvii) True; (xviii) False; (xix) True; (xx) False.

2. *Fill-in-the blanks with **appropriate** words:*

(i) fixed; (ii) 6% p.a. (iii) profit; (iv) equally; (v) Profit and Loss Appropriation Account; (vi) two; (vii) fifty; (viii) appropriation; (ix) profit; (x) Optional; (xi) Profit and Loss Appropriation Account; (xii) duty; (xiii) Profit, Loss; (xiv) Profit and Loss Account; (xv) Partnership Deed; (xvi) agreed ratio; (xvii) charge; (xviii) Fluctuating; (xix) 5.5; (xx) all.

3. ***Match** the following:*

1. (i) (a); 2. (i) (b), (ii) (a); 3. (i) (a), (ii) (b); 4. (i) (a), (ii) (b); 5. (i) (c), (ii) (a); 6. (i) (a); 7. (i) (a), (ii) (c); 8. (i) (b).

Multiple Choice Questions (MCQs)

*Select the **correct** alternative:*

1. (a); 2. (b); 3. (a); 4. (d); 5. (d); 6. (b); 7. (a); 8. (a); 9. (b); 10. (c); 11. (c); 12. (d); 13. (d); 14. (c); 15. (c); 16. (b); 17. (c); 18. (c); 19. (b); 20. (c); 21. (d); 22. (b).

Very Short Answer Type Questions

25. [**Hints:** (i) interest on capital, (ii) salary, (iii) commission, (iv) share of profit.]

26. [**Hints:** (i) interest on drawings, (ii) drawings, (iii) share of loss.]

37. [**Hint:** Yes, if partners have agreed that one or more of them shall not be liable for losses.]

39. [**Hint:** Seema's Commission = 10/110 of ₹ 2,20,000 [₹ 2,27,500 – ₹ 7,500 (Salaries) = ₹ 20,000.]

51. [**Hint:** Unlimited liability means that the liability of a partner is joint and several. The personal assets of the partner can be utilised for paying a firm's debts.]

55. [**Hint:** In their old profit-sharing ratio.]

Exercise

1. (a) Not allowed; (b) Not allowed;
(c) 6% p.a.; (d) Equal;
(e) Not charged; (f) Allowed @ 6% p.a.;
(g) Not charged.
2. (a) *P* must pay—₹ 25,000; (b) *Q* must pay—₹ 5,000;
(c) Goods may be bought from *A Ltd.*; (d) C cannot be admitted;
(e) *R* will get interest @ 6% p.a.
3. (a) *A*'s claim is not accepted, (b) *B*'s claim is not accepted,
(c) *A* and *B*'s claim is not accepted; *C* will not pay interest in the absence of agreement, and
(d) Profits or losses should be distributed among the partners equally. The claim made by *A* and *B* is not accepted.
4. In the absence of Partnership Deed, the provisions of Indian Partnership Act, 1932 will apply:
(a) No interest will be paid on extra capital introduced.
(b) Deep cannot be admitted as Bose and Chatterjee don't agree.
(c) No interest will be charged from Chatterjee as rate of interest was not agreed.
(d) Interest on drawings will not be charged from Sarkar.
5. Harshad and Dhiman each gets ₹ 88,500 as profit and Harshad gets ₹ 3,000 as Interest on Loan.
[**Hint:** *Harshad's Claim:* (a) Harshad is not entitled to any interest on capital, but he is entitled to interest on his loan @ 6% p.a.;
(b) Profits will be distributed equally as per Partnership Act, 1932.
Dhiman's Claim: (a) His claim is right that profits should be shared equally;
(b) No remuneration will be allowed to Dhiman;
(c) Interest on capital will not be allowed.]
6. *A* and *B* each gets ₹ 7,380 as profit and *A* gets ₹ 240 as interest on *A*'s loan.
7. Interest Payable to *A*—₹ 30,000 × 3/5 × 6/100 × 6/12 = ₹ 540;
Interest Payable to *B*—₹ 30,000 × 2/5 × 6/100 × 6/12 = ₹ 360.
[**Hint:** According to the Indian Partnership Act, 1932, interest @ 6% p.a. is payable on the amount of loan given by partners. In the present case, interest will be payable for 6 months, *i.e.*, from 1st October, 2019 to 31st March, 2020.]
8. Interest on *X*'s Loan ₹ 2,400; Interest on *Y*'s Loan ₹ 1,200;
Case 1. Profit: *X* ₹ 6,960; *Y* ₹ 10,440;
Case 2. Loss: *X* ₹ 240; *Y* ₹ 360;
Case 3. Profit: *X* ₹ 560; *Y* ₹ 840;
Case 4. Loss: *X* ₹ 2,000; *Y* ₹ 3,000.
[**Hint:** Interest on Partner's Loan is a charge against profit.]
9. Share of Loss: Bat—₹ 31,920; Ball—₹ 47,880.
[**Hint:** Interest on Partner's Loan and Rent are charges against profit.]
10. ₹ 40,000 [(₹ 1,03,000 – ₹ 3,000) (interest on Loan by Akhil)—₹ 60,000 (rent)] will be distributed in the ratio of 3 : 2. Akhil—₹ 24,000; Bimal—₹ 16,000.
[**Hint:** In the absence of agreement, Akhil will get interest @ 6% p.a. on loan given by him. Interest will not be charged on loan to Bimal by the firm. Also, rent will be paid to Akhil as per the agreement.]
11. Interest credited to Loan Accounts of Ankit and Bhanu—₹ 7,500 each; Interest debited to Charu's Capital Account—₹ 3,000.
12. Amount of Profit transferred to Profit and Loss Appropriation A/c—₹ 34,000.
13. Share of Profit: *A*—₹ 17,200; *B*—₹ 17,200.
14. Divisible Profit—₹ 2,75,000.
15. Provision for Manager's Commission—₹ 15,000 (*i.e.*, 5% of ₹ 3,00,000), Share of Profit: *X*—₹ 93,000; *Y*—₹ 62,000.

16. Divisible Profit—₹ 34,750; Share of Profit: Prem—₹ 20,850; Manoj—₹ 13,900.

17. Share of Profit: Atul—₹ 72,000; and Mithun—₹ 48,000.

18. Loss—₹ 94,000; Reema's Share—₹ 47,000; Seema's Share—₹ 47,000.

19. Loss—₹ 48,750; Dr. Bhanu's Current A/c and Partap's Current Account by ₹ 24,375 each.

20. Dr. Profit and Loss Appropriation A/c by ₹ 40,000;
Cr. Amar's Current A/c by ₹ 15,000 and Bimal's Current A/c by ₹ 25,000.

21. Dr. Profit and Loss Appropriation A/c by ₹ 1,00,000;
Cr. Kamal's Current A/c by ₹ 55,000 and Kapil's Current A/c by ₹ 45,000;
Share of Profit: Kamal—₹ 2,50,000 and Kapil—₹ 2,50,000.
[**Hint:** Profit-sharing ratio between Kamal and Kapil is not given. Hence, they will share profit equally.]

22. (i) Dr. Profit and Loss Appropriation A/c by ₹ 20,000;
Cr. Simran's Current A/c by ₹ 10,000 and Reema's Current A/c by ₹ 10,000;
(ii) Dr. Profit and Loss Appropriation A/c by ₹ 2,80,000;
Cr. Simran's Current A/c by ₹ 1,68,000 and Reema's Current A/c by ₹ 1,12,000.
[**Hint:** Interest will not be allowed on Current Account balances.]

23. Dr. Profit and Loss Appropriation A/c by ₹ 90,000;
Cr. Anita's Capital A/c by ₹ 50,000 and Ankita's Capital A/c by ₹ 40,000.

24. (i) Dr. Profit and Loss Appropriation A/c by ₹ 1,35,000;
Cr. Ashish's Capital A/c by ₹ 65,000 and Aakash's Capital A/c by ₹ 70,000;
(ii) Share of Profit: Ashish—₹ 2,19,000 and Aakash—₹ 1,46,000.
[**Hint:** Interest on capital is allowed on opening balances of capital.]

25. *For Interest on Capital:*
Dr. Profit and Loss Appropriation A/c by ₹ 82,500;
Cr. Naresh's Capital A/c by ₹ 42,500 and Sukesh's Capital A/c by ₹ 40,000;
For Profit distribution:
Dr. Profit and Loss Appropriation A/c by ₹ 1,17,500;
Cr. Naresh's Capital A/c by ₹ 58,750 and Sukesh's Capital A/c by ₹ 58,750.

26. Interest on Capital: Jay—₹ 4,800; Vijay—₹ 3,000.
[**Hint:** Since the amount of net profit is less than the total amount of Interest on Capital, *i.e.*, ₹ 7,200 (Jay) + ₹ 4,500 (Vijay) = ₹ 11,700, the net profit has been distributed in the ratio of interest claims of Jay and Vijay, *i.e.*, ₹ 7,200 : ₹ 4,500 or 8 : 5.]

27. Interest on Capital: Neelkant—₹ 50,000; Mahadev—₹ 50,000.

28. Interest on Long's Capital—₹ 10,800; Interest on Short's Capital—₹ 13,200.

29. (i) Interest on Capital: Moli—₹ 1,000; Bholi—₹ 500; (ii) Loss: Moli—₹ 120; Bholi—₹ 180.

30. Interest on Capital: Amit—₹ 1,08,000; Bramit—₹ 84,000.

31. Share of Profit—₹ 80,000 each.

32. Commission Payable to *A*—₹ 11,000.

33. Commission Payable to *Z*—₹ 20,000.

34. Commission payable to the partners = 20/120 × ₹ 1,80,000 = ₹ 30,000 which will be shared as: *A*—₹ 6,000; *B*—₹ 9,000; *C*—₹ 6,000 and *D*—₹ 9,000. Share of Profits: *A*—₹ 60,000; *B*—₹ 45,000; *C*—₹ 30,000 and *D*—₹ 15,000.

35. *X*'s Commission—₹ 27,500; *Y*'s Commission—₹ 22,500; Net Profit—₹ 2,25,000; *X* and *Y*'s Share—₹ 1,12,500 each.
[**Hint:** *Y*'s Commission = 10/110 of ₹ 2,47,500 (*i.e.*, ₹ 4,20,000 – ₹ 1,20,000 (*X*'s Salary) – ₹ 25,000 (*Y*'s Salary) – ₹ 27,500 (*X*'s Commission)).]

36. Ram—₹ 3,600 and Mohan—₹ 2,400.

[**Hint:** When the dates of drawings are not given, interest on drawings is calculated on the total amount of drawings for average period of 6 months.]

37. Interest on Brij's Drawings—₹ 2,400 and Interest on Mohan's Drawings—₹ 1,800.

38. Interest on Drawings—₹ 7,200.

39. Interest on Drawings—₹ 350.

[**Hint:** Interest on drawings will be charged for average period of 3.5 months on total drawings.]

40. Interest on Drawings—₹ 810.

41. Interest on Drawings—₹ 250.

[**Hint:** Interest on drawings will be charged for average period of 2.5 months on total drawings.]

42. Case 1—₹ 1,875; Case 2—₹ 1,125; Case 3—₹ 1,500.

43. Interest on Drawings: Kanika—₹ 1,500; Gautam—₹ 2,250.

44. *C* will get ₹ 23,200 and *D*—₹ 56,800.

45. Share of Profit: Amit—₹ 75,420; Vijay—₹ 50,280.

46. Sohan's Capital A/c—₹ 4,69,750; Mohan's Capital A/c—₹ 3,37,250.

47. Commission of *B*—₹ 1,581; Share of Profit: *A*—₹ 23,714; *B*—₹ 7,905; Capital A/cs: *A*—₹ 74,714; *B*—₹ 41,286.

48. Closing Balances of Capital A/cs: Sajal—₹ 8,09,000; Kajal—₹ 5,31,100; Share of Profit: Sajal—₹ 3,87,000; Kajal—₹ 1,93,500; General Reserve—₹ 64,500.

[**Hint:** Interest on loan by a partner is a charge.]

49. Current Accounts: Ali—₹ 19,642; Bahadur—₹ 10,883; Amount transferred to Reserve—₹ 3,475.

50. Share of Profit: *A*—₹ 4,170 and *B*—₹ 2,780; Balances of Capital A/cs: *A*—₹ 57,170 and *B*—₹ 37,080.

[**Hint:** Manager's Commission and rent are charges against profit. Hence, they will be transferred to Profit and Loss Account to determine Net Profit before appropriations (such as partner's salary, interest on capital).

Dr. PROFIT AND LOSS ACCOUNT *for the year ended ...* *Cr.*

Particulars	₹	Particulars	₹
To Rent A/c	24,000	By Profit (given)	39,000
To Manager's Commission A/c (5/100 × ₹ 15,000)	750		
To Net Profit trfd. to P & L App. A/c	14,250		
	39,000		39,000

]

51. Divisible Profit—₹ 1,40,000; *A*'s share—₹ 50,000; *B*'s share—₹ 44,000; *C*'s share—₹ 46,000.

52. Share of Profit: *A*—₹ 15,000; *B*—₹ 9,000; *C*—₹ 6,000; Balances of Current A/cs: *A* (Cr.)—₹ 12,000; *B* (Cr.)—₹ 9,500; *C* (Cr.)—₹ 7,000.

53. Divisible Profit—₹ 2,76,190; Commission (Binita)—₹ 23,810; General Reserve—₹ 50,000; Share of Profit: Amit—₹ 92,063; Binita—₹ 92,063, Charu—₹ 92,064; Closing Balances of Capital A/cs: Amit—₹ 3,17,063; Binita—₹ 3,25,873; Charu—₹ 4,07,064.

54. Interest on Anshul's Capital—₹ 20,000; Salary to Asha—₹ 12,000.

[**Hint:** Since, both interest on capital and salary to partner are appropriations and net profit is less than the amount of appropriations to be made, net profit has been distributed in the ratio of appropriations to be made, *i.e.*, ₹ 40,000 (interest on Anshul's capital) : ₹ 24,000 (Asha's salary) or 5 : 3.]

55. Share of Profit: Kabir—₹ 40,000; Zoravar—₹ 32,000; Parul—₹ 88,000.

[**Hints:** 1. Since, net profit is not adequate to meet the appropriations, it is distributed in the ratio of appropriation to be made, *i.e.*, ₹ 50,000 : ₹ 40,000 : ₹ 1,10,000 or 5 : 4 : 11.
2. In the absence of divisible profit, amount will not be transferred to General Reserve.]

56. Interest on Capital: *X*—₹ 24,000; *Y*—₹ 18,000; Salary: *X*—₹ 60,000; *Y*—₹ 90,000; Commission: *X*—₹ 17,500; Interest on Drawings: *X*—₹ 5,000; *Y*—₹ 6,250; Share of Profit: *X*—₹ 1,18,125; *Y*—₹ 93,125; Capital Balance: *X*—₹ 3,14,625; *Y*—₹ 2,19,875; Interest on *X*'s Loan: ₹ 1,500; Transfer to General Reserve—₹ 50,000.

57. Debit Nisha's Capital A/c and Credit Reya's Capital A/c by ₹ 55,000.

58. Debit *P*'s Current A/c and Credit *Q*'s Current A/c by ₹ 6,000.

59. Debit Azad by ₹ 1,000 and Credit Benny by ₹ 1,000.

60. Debit Ram and Credit Sohan by ₹ 300.

61. Debit Shyam's Current A/c by ₹ 200 and Mohan's Current A/c by ₹ 400; Credit Ram's Current A/c by ₹ 600.

62. (a) Simrat—₹ 35,400; Bir—₹ 27,300; (b) Simrat—₹ 33,960; Bir—₹ 25,140.

63. Debit Pankaj's Capital A/c and Credit Anu's Capital A/c by ₹ 1,000.

64. Debit Usha's Capital A/c and Credit Mita's Capital A/c by ₹ 6,816.

65. Dr. *A*'s Current A/c—₹ 16,080; Cr. *B*'s Current A/c—₹ 14,253 and *C*'s Current A/c—₹ 1,827.

[**Hint:** *C*'s Commission = 5/100 × ₹ 74,000 [*i.e.*, ₹ 80,000 – ₹ 6,000 (Interest on Capital)] = ₹ 3,700.]

66. Debit *P*'s Capital A/c by ₹ 300; Credit *Q*'s Capital A/c by ₹ 8 and *R*'s Capital A/c by ₹ 292.

[**Hint:** Opening Capital: *P*—₹ 20,000; *Q*—₹ 17,500; *R*—₹ 14,500.]

67. Debit Anil by ₹ 550 and Credit Mohan by ₹ 550; Corrected Profit transferred to each partner ₹ 6,100.

68. Debit Bina's Capital A/c and Credit Piya's Capital A/c by ₹ 5,856.

69. Dr. Rajesh's Current A/c—₹ 17,800; Cr. Naveen's Current A/c—₹ 10,000 and Qadir's Current A/c—₹ 7,800.

70. Debit Shristhi and Credit Mannu by ₹ 2,880.

71. Dr. Sudhir's Current A/c—₹ 6,000; Cr. Mudit's Current A/c—₹ 1,000 and Uday's Current A/c—₹ 5,000.

72. Dr. *A*'s Capital A/c—₹ 2,520 and *C*'s Capital A/c—₹ 2,740; Cr. *B*'s Capital A/c—₹ 5,260.

73. Dr. Bobby's Capital A/c—₹ 14,402; Cr. Abhir's Capital A/c—₹ 10,112; and Vineet's Capital A/c—₹ 4,290.

74. Dr. Saroj's Capital A/c—₹ 2,350 and Mahinder's Capital A/c—₹ 1,300; Cr. Umar's Capital A/c—₹ 3,650.

75. Debit *A* by ₹ 66,000 and Credit *B* by ₹ 30,000 and *C* by ₹ 36,000.

76. Partners' Capital Accounts: *A*—₹ 3,98,790; *B*—₹ 3,01,210; Capitals on 1.4.2018: (Opening Capital): *A*—₹ 3,28,000; *B*—₹ 2,56,000; Interest on Capital: *A*—₹ 16,400; *B*—₹ 12,800; Interest on Drawings: *A*—₹ 900; *B*—₹ 450.

[**Hints:** (i) *For Interest on Capital:* Dr. Profit and Loss Adjustment A/c: ₹ 29,200;
Cr. *A*'s Capital A/c: ₹ 16,400 and *B*'s Capital A/c: ₹ 12,800.
(ii) *For Interest on Drawings:* Dr. *A*'s Capital A/c: ₹ 900 and *B*'s Capital A/c: ₹ 450;
Cr. Profit and Loss Adjustment A/c: ₹ 1,350.
(iii) *Loss on Adjustment:* Dr. *A*'s Capital A/c: ₹ 16,710 and *B*'s Capital A/c: ₹ 11,140;
Cr. Profit and Loss Adjustment A/c: ₹ 27,850.]

77. Debit Harry by ₹ 50,000 and Porter by ₹ 50,000; Credit Ali by ₹ 1,00,000.

78. *A*'s share—₹ 26,400; *B*'s share—₹ 17,600; *C*'s share—₹ 10,000.

79. Share of Profit: *A*—₹ 1,60,000; *B*—₹ 80,000; *C*—₹ 75,000.

80. Net Profit—₹ 1,27,500; Share of Profit: *X*—₹ 51,000 – ₹ 1,750 = ₹ 49,250; *Y*—₹ 1,27,500 × 3/10 = ₹ 38,250; *Z*—₹ 38,250 + ₹ 1,750 = ₹ 40,000.

[**Hint:** Guaranteed amount for half-year = ₹ 80,000 × 1/2 = ₹ 40,000.]

81. Deficiency to be met by *B* in: 2019—₹ 20,000; 2020—Nil.

82. Deficiency of *C*—₹ 1,000 borne by *A* and *B* equally, *i.e.*, ₹ 500 each.

83. Deficiency of Vandana—₹ 37,500 borne by Vikas—₹ 22,500 and Vivek—₹ 15,000. Share of Profit: Vikas—₹ 4,50,000; Vivek—₹ 3,00,000; Vandana—₹ 1,50,000.

84. (a) *A*—₹ 14,400; *B*—₹ 9,600 and *C*—₹ 6,000;

(b) *A*—₹ 14,000; *B*—₹ 10,000 and *C*—₹ 6,000;

(c) *A*—₹ 15,000; *B*—₹ 9,000 and *C*—₹ 6,000;

(d) *A*—₹ 14,250; *B*—₹ 9,750 and *C*—₹ 6,000.

85. Share of Profit: *A*—₹ 96,750; *B*—₹ 72,000; *C*—₹ 56,250.

86. *For Deficiency—year ended 31st March, 2018:*

Dr. *P*'s Capital A/c—₹ 3,600 and *Q*'s Capital A/c—₹ 2,400;

Cr. *R*'s Capital A/c—₹ 6,000.

For Deficiency—year ended 31st March, 2020:

Dr. *P*'s Capital A/c—₹ 32,400 and *Q*'s Capital A/c—₹ 21,600;

Cr. *R*'s Capital A/c—₹ 54,000.

87. Share of Profit: Asgar—₹ 70,000; Chaman—₹ 40,000 and Dholu—₹ 70,000.

[**Hint:** Deficiency of ₹ 10,000 in Dholu's share is recovered from Asgar.]

88. Share of Profit: Ankur—₹ 4,14,000; Bhavna—₹ 1,80,000 and Disha—₹ 1,26,000.

[**Hint:** Deficiency of ₹ 6,000 is contributed by Ankur for Disha.]

89. Dr. Ajay's Capital A/c: ₹ 6,400 and Binay's Capital A/c: ₹ 2,000; Cr. Chetan's Capital A/c: ₹ 8,400.

90. Dr. Bhanu's Capital A/c—₹ 21,000 and Chand's Capital A/c—₹ 2,000; Cr. Alia's Capital A/c—₹ 23,000.

91. *A*'s share—₹ 41,400; *B*'s share—₹ 18,600; *C*'s share—₹ 15,000.

[**Hint:** The Gross fee of ₹ 16,000 earned by *B* for the firm is less than the amount guaranteed by him. So the deficiency of ₹ 9,000 (*i.e.*, ₹ 25,000 – ₹ 16,000) will be debited to *B*'s Capital Account and credited to Profit and Loss Appropriation Account.]

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