CHAPTER – I

Accounting for partnership firms – Fundamentals

LEARNING OBJECTIVES:

After studying this chapter the student will be confident to:

- Understand and explain the meaning of partnership
- Understand the characteristics of Partnership
- Explain the meaning and contents of partnership deed.
- Apply their provisions of Partnership Act, 1932 in the absence of partnership deed.
- Prepare partners' Fixed and fluctuating capital Accounts.
- Calculate interest on Capital and Drawings.
- Distribute profit among partners and prepare Profit and Loss Appropriation A/c.
- Make the accounting treatment of past adjustment.

SALIENT POINTS:

- Partnership deed: It is a document which contains the terms and conditions of Partnership agreement either oral or written.
- Profit and Loss Appropriation Account : After the preparation of Profit and Loss account, entries pertaining to Interest on Capital, Drawings , Salaries among the partners are shown separately in a newly opened Profit and Loss Appropriation Account.
- Rules applicable in the absence of Partnership Deed :

  a) Profit sharing ratio will be equal

  b) No Interest on Capital and Drawings

  c) No Remuneration or Salary to the partners.

  d) Interest on Loan advanced by the partner @6%p.a.
- Fixed and Fluctuating Capital Accounts :

  When the Capitals are fixed, the Current account of the partners will be maintained.

1 and 3 Mark Questions

Q1 Define partnership.

Ans. When two or more persons enter into an agreement to carry on business and share its profit and losses, it is a case of partnership. The Indian partnership Act, 1932, defines Partnership as follows:

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

Q.2 What do you understand by 'partners', 'firm' and 'firms' name?

Ans. The persons who have entered in to a Partnership with one another are individually called 'Partners' and collectively 'a firm' and the name under which the business is carried is called 'the firm's name'.

Q.3 Write any four main features of partnership.

Ans. Essential elements or main features of Partnership :

i) Two or more persons: Partnership is an association of two or more persons.

ii) Agreement: The Partnership is established by an agreement either oral or in writing.

iii) Lawful Business: A Partnership formed for the purpose of carrying a business, it must be a legal business.

iv) Profit sharing: Profit of the firm is share by the partners in an agreed ration, if the ratio is not agreed then equally. Profit also includes loss.

Q.4 What is the minimum and maximum number of partners in all partnership?

Ans. There should be at least two persons to form a Partnership. The maximum number of Partners in a firm carrying an banking business should not exceed ten and in any other business should not exceed ten and in any other business it should not exceed twenty.

Q.5 What is the status of partnership from an accounting viewpoint?

Ans. From an accounting viewpoint, partnership is a separate business entity. From legal viewpoints, however, a Partnership, like a sole proprietorship, is not separate from the owners.

Q.6 What is meant by partnership deed?

Ans. Partnership deed is a written agreement containing the terms and conditions agreed by the Partners.

Q.7 State any four contents of a partnership deed.

i) The date of formation and the duration of the Partnership

ii) Name and address of the Partners

iii) Name of the firm.

iv) Interest on Partners capital and drawings

v) Ratio in which profit or losses shall be shared

Q.8 In the absence of a partnership deed, how are mutual relations of partners governed?

Ans. In the absence of Partnership deed, mutual relations are governed by the Partnership Act, 1932.

Q.9 Give any two reason in favour of having a partnership deed.

Ans. i) In case of any dispute or doubt, Partnership deed is the guiding document.

ii) It can specify the duties and powers of each Partner.

Q.10 State the provision of 'Indian partnership Act 1932' relating to sharing of profits in absence of any provision in the partnership deed.

Ans. In the absence of any provision in the Partnership deed, profit or losses are share by the Partners equally.

Q.11 Why is it important to have a partnership deed in writing?

Ans. Partnership deed is important since it is a document defining relationship of among Partners thus is assistance in settlement of disputes, if any and also avoids possible disputes: it is good evidence in the court.

Q.12 What do you understand by fixed capital of partners?

Ans. Partners' capital is said to be fixed when the capital of Partners remain unaltered except in the case where further capital is introduced or capital is withdrawn permanently.

Q.13 What do you understand by fluctuating capital of partners?

Ans. Partner’s capital is said to be fluctuating when capital alters with every transaction in the capital account. For example, drawing, credit of interest, etc

Q.14 Give two circumstances in which the fixed capital of partners may change.

Ans. Two circumstances in which the fixed capital of Partners may change are :

i) When additional capital is introduced by the Partners.

ii) When a part of the capital is permanently withdrawn by the Partners.

Q.15 List the items that may appear on the debit side and credit side of a partner's fluctuating capital account.

Ans. On debit side: Drawing, interest on drawing, share of loss, closing credit balance of the capital.

On credit side : Opening credit balance of capital, additional capital introduced, share of profit, interest on capital, salary to a Partner, commission to a Partner.

Q.16 How will you show the following in case the capitals are?

i) Fixed and ii) Fluctuating

. a) Additional capital introduced

b) Drawings

c) Withdrawal of capital

d) Interest on capital and

e) Interest on loan by partners?

Ans.i) In case, capitals are fixed:

a) On credit side of capital (b) on debit side of current A/c (c) on debit side of capital A/c (d) on credit side of current A/c (e) on credit side of loan from partner's A/c

Q.17 If the partners capital accounts are fixed, where will you record the following items :

i) Salary to partners

ii) Drawing by a partners

iii) Interest on capital and

iv) Share of profit earned by a partner?

Ans. i) Credit side of Partner's current A/c
ii) Debit side of Partner's current A/c
iii) Credit side of Partners current A/c
iv) Credit side of Partners current A/c

Q.18 How would you calculate interest on drawings of equal amounts drawn on the Last day of every month?

Ans. When a partners draws a fixed amount at the beginning of each month, interest on total drawing would be on the amount withdraw for 6.5 months at the agreed rate of interest per annum. Apply the following formula.

Interest on drawing = total drawing x $\boxed{\dfrac{\text{Rate X 6.5}}{\text{100 X 12}}}$

Q.19 How would you calculate interest on drawing of equal amounts drawn on the last day of every month?

Ans. When drawing of fixed amounts are made at regular monthly intervals on the day of every month, Interest would be charged on the amount withdrawn at the agreed rate of interest for 5.5 months. Apply the following formula. :

Interest on drawing = Total drawing x $\boxed{\dfrac{\text{Rate X 5.5}}{\text{100 X 12}}}$

Q.20 How would you calculate interest on drawing of equal amount drawn in the middle of every month?

Ans. Interest on drawing = Total drawing x $\boxed{\dfrac{\text{Rate X 6.0}}{\text{100 X 12}}}$

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Q.21 Ramesh, a partner in the firm has advanced a loan of a Rs. 1,00,000 to the firm and has demanded on interest @ 9% per annum. The partnership deed is silent on the matter. How will you deal with it?

Ans. Since the Partnership deed is silent on payment of interest, the provisions of the Partnership Act, 1932 will apply. Accordingly, Ramesh is entitled to interest @ 6% p.a.

Q.22 The partnership deed provides that Anjali, the partner will get Rs. 10,000 per month as salary. But, the remaining partners object to it. How will this matter be resolved?

Ans. No, he is not entitled to the salary because it is not so, Provided in the Partnership deed and according to the Partnership act, 1932 if the Partnership deed does not provided for payment of salary to Partners, he will not be entitled to it.

Q.23 Distinction between Profit and loss and profit and loss appropriation account:

Ans.

	Profit & Loss A/c		Profit & Loss Appropriation A/c
i)	Profit and Loss A/c is prepared to ascertain net profit or net loss of the business for an accounting year.	i)	In case of partnership firms, profit and loss appropriation A/c is prepared to appropr iate / distribute the profit of the year among partners.
ii)	It is prepared by all the business firms.	ii)	Only partnership firms and companies prepare profit and loss appropriation A/c

Q.24. State the Average period to be taken for calculating interest on drawing in different cases if amount is withdrawn on regular interval.

Ans. **TABLE SHOWING THE AVERAGE PERIOD WHEN WITHDRAWALS ARE MADE REGULARLY**

	DATE OF WITHDRAWAL	AVERAGE PERIOD
1	Beginning of every month	(12+1)/2 = 6.5
	Middle of every month	(11.5+0.5)/2 = 6
	End of every month	(11+0)/2 = 5.5
2	Beginning of every quarter	(12+3)/2 = 7.5
	End of every quarter	(9+0)/2 = 4.5
3	Beginning of half year	(12+6)/2 = 9
	End of half year	(6+0)/2 = 3

PROBLEMS BASED ON FUNDAMENTALS

Q. 1 A, B, and C were partners in a firm having no partnership agreement. A, B and C contributed Rs.2, 00,000, Rs.3, 00,000 and 1, 00,000 respectively. A and B desire that the profits should be divided in the ratio of capital contribution. C does not agree to this. How will the dispute be settled?

ANS: C is correct because in the absence of Partnership deed the profits are to be shared equally.

Q2 A and B are partners sharing profits in the ratio of 3: 2 with capitals of Rs. 5, 00,000 and Rs. 3, 00,000 respectively. Interest on capital is agreed @ 6% p.a. B is to be allowed an annual salary of Rs. 25000. During 2006, the profits of the year prior to calculation of interest on capital but after charging B's salary amounted to Rs. 1,25,000. A provision of 5% of the profits is to be made in respect of Manager's commission.

Prepare an account showing the allocation of profits and partners' capital accounts.

Solution:2 **Profit and Loss Appropriation Account**

Particulars		**Amount** Rs.	**Particulars**	**Amount** Rs.
To Interest on Capital			By Profit after B's Salary but before other adjustments	1, 25,000
A	30,000			
B	18,000	48000		
To Prov.Manager's Commission (5% of Rs.1, 50,000*)		7,500		
To Profit transferred to:				
A's Capital A/c	41700			
B's Capital A/c	27800	69,500		
		125000		**125,000**

Partner's capital Accounts

Particulars	**A**	**B**	**Particulars**	**A**	**B**
To Balance c/d	571700	370800	By Balance b/d	500000	300000
			By interest on capital	30000	18000
			By salary	-	25000
			By P and L Appropriation A/c	41700	27800

571700 370800 **571700 370800**

Q.3 X and Y are partners sharing profits and losses in the ratio of 3: 2 with capitals of Rs. 50,000 and Rs. 30,000 respectively. Each partner is entitled to 6% interest on his capital. X is entitled to a salary of Rs. 800 per month together with a commission of 10% of net 'Profit remaining after deducting interest on capitals and salary but before charging any commission. Y is entitled to a salary of Rs. 600 per month together I. with-a commission of 10% of Net profit remaining after deducting interest on capitals and salary and after charging all commissions. The profits for the year prior to calculation of interest on capital but after charging salary of partners amounted to Rs. 40,000. Prepare partners' Capital Accounts:-

(i) When capitals are fixed, and

(ii) When capitals are. Fluctuating.

Note: (1) Calculation of interest on Capital: Interest for 3 months i.e. from 1st April to 30th June, 2004

	A	B
A on Rs. 5,00,000 @ 10% p.a.	12500	
B on Rs. 3,00,000 @ 10% p.a.		7500
Interest for 9 months i.e. from 1st July, 2004 to 31st March, 2005:		
A on Rs. 3,50,000 @ 10% p.a.	26250	
B on Rs. 3,50,000 @ 10% p.a.		26250

Q 4 Give the answer to the following:

(1) P and Q are partners sharing profits and losses in the ratio of 3:2. On 1st April 2009 their capital balances were Rs.50, 000 and 40,000 respectively. On 1st July 2009 P brought Rs.10, 000 as his additional capital whereas Q brought Rs.20, 000 as additional capital on 1st October 2009. Interest on capital was provided @ 5% p.a. Calculate the interest on capital of P and Q on 31st March 2010.

(2) A and B are partners sharing profits and losses in the ratio of 2:1. A withdraws Rs.1500 at the beginning of each month and B withdrew Rs. 2000 at the end of each month for 12 months. Interest on drawings was charged @ 6% p.a. Calculate the interest on drawings of A and B for the year ended 31st December 2009.

Ans. 1 Interest on Capital for A

DATE	AMOUNT	NO. OF MONTHS	PRODUCT
1-4-2009 TO 31-3-10	50,000	12	6,00,000
1-7-2009 TO 31-3-10	10,000	09	90,000
		TOTAL	6,90,000

Interest on capital for A will be = 6, 90,000 x 5/100 x 1/12
= 2,875

For B

DATE	AMOUNT	NO OF MONTHS	PRODUCT
1-4-2009 to 31-3-10	40,000	12	4,80,000
1-10-2009 to31-3-10	20,000	06	1,20,000
		TOTAL	6,00,000

Interest on capital for B will be = 6, 00,000 x 5/100 x 1/12
= 2,500

Ans. 2 **Interest on Drawings**

For A = Total drawings of the year x rate/100 x Average calculated period

= 18,000x6/100 x 13/2 x1/12 = 585

For B = 24,000 x 6/100 x 11/2 x1/12 = 660

Q.5 A, B and C are partners in a firm sharing profits and losses in the ratio of 2:3:5. Their fixed capitals were 15, 00,000, Rs.30, 00,000 and Rs.6, 00,000 respectively. For the year 2009 interest on capital was credited to them @ 12% instead of 10%. Pass the necessary adjustment entry.

Ans: TABLE SHOWING ADJUSTMENT

PARTICULARS	A RS	B RS	C RS	TOTAL RS
Interest that should have been credited @ 10%	1,50,000	3,00,000	6,00,000	10,50,000
Interest already credited @ 12%	1,80,000	3,60,000	7,20,000	12,60,000
Excess credit in partners account	(30,000)	(60,000)	(1,20,000)	(2,10,000)
By recovering the extra amount paid the share of profits will				

increase and it will be credited in				
the ratio of 2:3:5	42,000	63,000	1,05,000	2,10,000
Net effect	+12,000	+3,000	-15,000	Nil

Adjustment Entry:

C's current A/c	Dr.	15,000	
To A's Current A/c			12,000
To B's Current A/c			3,000
(For interest less charged on capital, now rectified)			

Q.6 From the following balance sheet of X and Y, calculate interest on capitals @ 10% p.a. payable to X and Y for the year ended 31st December, 2008.

Liabilities	Amount	Assets	Amount
X's Capital	50,000	Sundry Assets	1, 00,000
Y's capital	40,000	Drawings X	10,000
P & L appropriation A/c (1998)	20,000		
	1,10,000		**1,10,000**

During the year 2008, X's drawings were Rs. 10,000 and Y's Drawing were Rs. 3,000. Profit during the year, 2008 was Rs.30, 000.

Ans : 6 Calculation of Opening Capitals

	X	Y
	Rs.	Rs.
Capitals as on 31st Dec., 2008	50,000	40,000
Add: Drawings (Previously deducted).	-	3,000
	50,000	43,000
Less: Profit distributed (30,000- 20,000' equally	5,000	5,000
Opening Capitals	45,000	38,000
Interest on 'capitals: @ 10% p.a;	4,500	3,800

Working Notes:

(1) As X's drawings are shown in the Balance Sheet, it means his drawings are not deducted. From his .capital till now, so his drawings are not included back.

(2) Profits for 2008 were Rs. 30,000 and profits of Rs. 20,000· are, shown in the Balance Sheet, which means only Rs. 10,000 profits were distributed between the partners.

Q.7 A, B and C entered into partnership on 1st April, 2008 to share profits & losses in the ratio of 4:3:3. A, however, personally guaranteed that C's share of profit after charging interest on Capital @ 5% p.a. would not be less than Rs. 40,000 in any year. The Capital contributions were:

A, Rs. 3, 00,000; B, Rs. 2, 00,000 and C, Rs. 1, 50,000.

The profit for the year ended on 31st March, '2008 amounted to Rs. 1, 60,000. Show the Profit & Loss Appropriation Account. .

Solution:7 **Profit and Loss Appropriation Account**

(*for the year ending on 31st March 2008*)

Particulars		**Amount**	**Particulars**	**Amount**
To Interest on Capital:			By Profit before adjustments	1,60,000
A	15,000			
B	10,000			
C	7,500	32,500		
To net Profit transferred				
A. (51,000-1,750)	49,250			
B. (1,27,500x3/10)	38,250			
C. (38,250+1,750)	40,000	1, 27,500		
		1,60,000		**1,60,000**

Q 8 A, and C are partners with fixed capitals of Rs. 2,00,000, Rs. 1,50,000 and Rs. 1,00,000 respectively. The balance of current accounts on 1st January, 2004 were A Rs. 10,000 (Cr.); B Rs. 4,000 (Cr.) and C Rs. 3,000 (Dr.). A gave a loan to the firm of Rs. 25,000 on 1st July, 2004. The Partnership deed provided for the following:-

(i) Interest on Capital at 6%.

(ii) Interest on drawings at 9%. Each partner drew Rs. 12,000 on 1st July, 2004.

(iii) Rs. 25,000 is to be transferred in a Reserve Account.

(iv) Profit sharing ratio is 5:3: 2 up to Rs. 80,000 and above Rs. 80,000 equally. Net Profit of the firm before above adjustments was Rs. 1,98,360.

From the above information prepare Profit and Loss Appropriation Account, Capital and Current Accounts of the partners.

Solution: 8

Profit and Loss Appropriation Account

for the year ended 31st December, 2004

Particulars		**Amount**	**Particulars**		**Amount**
To Interest on Capital at 6% :			By profit and Loss A/c	198360	
A	12000		Less: interest on A's Loan		
B	9000		@ 6% p.a.on Rs 25,000		
C	6000	27000	for six months	750	197610
			By interest on drawings @ 9% p.a. for 6 months on Rs 12,000		
			A	540	
To reserve A/c		25000	B	540	
To profit			C	540	1620
A's current A/c	62410				
B's current A/c	46410				
C's current A/c	38410	147230			
		199230			**199230**

Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
To balance c/d	2,00,000	1,50,000	1,00,000	By balance b/d	2,00,000	1,50,000	1,00,000

Current accounts

Particulars	A	B	C	Particulars	A	B	C
To balance b/d	-	-	3000	By balance b/d	10000	4000	-

To drawings	12000	12000	12000	By interest on capital	12000	9000	6000
To interest on drawings	540	540	540	By P&L A/c	62410	46410	38410
To balance c/d	71870	46870	28870				
	84,410	**59,410**	**44,410**		**84,410**	**59,410**	**44,410**

Calculation of Distribution of Profits:

Up to Rs. 80000 in the ratio of 5:3:2

Above Rs. 80,000 equally

Q.9 Ram and Shyam started a partnership business on 1st January, 2007. Their capital contributions were Rs. 2,00,000 and Rs. 10,0000 respectively. The partnership deed provided:

i. Interest on capitals @10% p.a.

ii. Ram, to get a salary of Rs. 2,000 p.m. and Shyam Rs. 3,000 p.m.

iii. Profits are to be shared in the ratio of 3:2.

The profits for the year ended 31st December, 2007 before making above appropriations were Rs. 2,16,000. Interest on Drawings amounted to Rs. 2,200 for Ram and Rs. 2,500 for Shyam. Prepare Profit and Loss Appropriation Account.

Ans:9 **Profit and Loss Appropriation Account**

for the year ending on 31st Dec., 2007

Particulars		**Amount**	**Particulars**		**Amount**
To Interest on Capital:	Rs.		ByProfit		2,16,000
			By Interest on Drawings		
Ram	20,000		Amit	2,200	
Shyam	15,000	35,000	Vijay	2,500	4,700
To Salary					
Ram	24,000				
Shyam	36,000	60,000			
To Net profit transferred					
Ram Capital A/c	75,420				
Shyam Capital A/c	50,280	1,25,700			
		2,20,700			**2,20,700**

Q.10 P and Q are partners with capitals of Rs. 6,00,000 and Rs. 4,00,000 respectively. The profit and Loss Account of the firm showed a net Profit of Rs. 4, 26,800 for the year. Prepare Profit and Loss account after taking the following into consideration:-

(i) Interest on P's Loan of Rs. 2,00,000 to the firm

(ii) Interest on 'capital to be allowed @ 6% p.a.

(iii) Interest on Drawings @ 8% p.a. Drawings were; P Rs 80,000 and Q Rs. 1000,000.

(iv) Q is to be allowed a commission on sales @ 3%. Sales for the year was Rs. 1000000

(v) 10% of the divisible profits is to be kept in a Reserve Account.

Solution:10 Profit and Loss Account for the year ended

Particulars	Amount	Particulars	Amount
To Interest on P's Loan A/c	12000	By profit before interest	426800
To Profit transferred to			
P&L Appropriation A/c	414800		
	426800		**426800**

Profit and Loss Appropriation Account for the year ended.

Particulars		Amount	Particulars		Amount
To interest on Capital			By profit and Loss A/c (Profit)		414800
P	36000		By interest on drawings		
Q	24000	60000	P	3200	
To Q's commission		60000	Q	2000	5200
To reserve A/c		30000			
To profit					
P's Capital	135000				
Q's capital	135000	270000			
		420000			**420000**

Notes:

(i) If the rate of interest on Partners' Loan is not given in the question, it is to be wed @ 6% p.a. according to the Partnership Act.

(ii) Interest on Partners' Loan is treated as a charge against Profit, so it is shown in the debit of Profit and Loss A/c.

(iii) If the date of Drawings is not given in the question, interest on drawings will be charged and average period of 6 months. .

(iv) Reserve Fund is calculated at 10% on Rs. 3,00,000 (i.e. Rs. 4,26,800 + Rs. 5,200-12,000 - Rs. 60,000 - Rs. 60,000.

Guarantee of profit

A, B and C arte partners. They admit D and guarantee that his share of profit will not be less than Rs. 20,000. Profits to be shared 4:3:3:2 respectively. Total profits were Rs. 96,000. It was agreed that excess payable to D over his share will be borne by A,B and C in the ratio of 3:2:1. Calculate share of profit for each partner.

Books of A,B and C

Profit and Loss appropriation account for the year ending………

Particulars	Rs.	Particulars	Rs.
To profit transferred to: A's Capital a/c (Rs.96,000x4/12) 32,000 Less: Deficiency borne 2,000	32,000	By Profit & Loss A/c	96,000
B's Capital A/c (96,000x3/12) 24,000 Less: Deficiency borne 1,333	22,667		
C's Capital A/C (Rs.96,000x3/12) 24,000 Less: Deficiency borne 667	23,333		
D's Capital A/C (Rs.96,000x2/12) 16,000 Add: Deficiency recoveredfrom the Capitals of: A 2,000 B 1,333 C 667	20,000		
	96,000		**96,000**