

# Chapter -1

## Accounting for Partnership : Basic Concepts

### EXERCISE-1.1

#### 1 Marks

**1. Mohan and Shyam are partners in a firm. State whether the claim is valid if the**

**partnership agreement is silent in the following matters:**

**(i) Mohan is an active partner. He wants a salary of Rs. 10,000 per year;**

**Answer Invalid**

In the absence of partnership agreement, no interest on capital, interest on drawings, salary, commission is to be allowed to partners.

**(ii) Shyam had advanced a loan to the firm. He claims interest @ 10% per annum;**

**Answer Invalid**

Interest on partners loan to be allowed @ 6% pa,

**(iii) Mohan has contributed Rs. 20,000 and Shyam Rs. 50,000 as capital. Mohan wants equal share in profits.**

**Answer Valid**

Profit and losses are to be shared equally.

**(iv) Shyam wants interest on capital to be credited @ 6% per annum.**

**Answer Invalid**

No interest on capital is to be allowed to partners.

**2. State whether the following statements are true or false:**

**(i)** Valid partnership can be formulated even without a written agreement between the partners;

**Answer** True

**(ii)** Each partner carrying on the business is the principal as well as the agent for all the other partners;

**Answer** True

**(iii)** Maximum number of partners in a banking firm can be 20;

**Answer** True

**(iv)** Methods of settlement of dispute among the partners can't be part of the partnership deed;

**Answer** False

**(v)** If the deed is silent, interest at the rate of 6% p.a. would be charged on the drawings made by the partner;

**Answer** False

**(vi)** Interest on partner's loan is to be given @ 12% p.a. if the deed is silent about the rate.

**Answer** False

**DO IT YOURSELF**

**Q.1.** Soumya and Bimal are partners in a firm Sharing profits and losses in the ratio of 3:2. The balance in their capital and current accounts as on April 01, 2006 were as under:

Items	Soumya (₹)	Bimal (₹)
Capital Accounts	3,00,000	2,00,000
Current Accounts (Cr)	1,00,000	80,000

The partnership deed provides that Soumya is to be paid salary @ Rs, 500 per month where as Bimal is to get a commission of Rs. 40,000 for the year. Interest on capital is to be credited at 6% p.a. The drawings of Soumya and Bimal for the year were Rs. 30,000 and Rs. 10,000 respectively. The net profit of the firm before making these adjustment was Rs, 2,49,000. Interest on Soumya's drawings was Rs. 750 and Bimal's drawings, Rs. 250. Prepare Profit and Loss Appropriation Account and Partner's Capital and Current Accounts.

### Profit and Loss Appropriation Account

Dr for the year ending 31 March, 2007 Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Soumya's Salary	6,000	By Profit and Loss	2,49,000
To Bimal's Commission	40,000	By Interest on Drawings	
To Interest on Capital		Soumya	750
Soumya	18,000	Bimal	250
Bimal	12,000		1,000
	30,000		
To Profit transferred to			
Soumya's Capital A/c	1,04,400		
Bimal's Capital A/c	69,600		
	1,74,000		
	2,50,000		2,50,000

Dr		Partners' Capital Account				Cr	
Particulars	Soumya	Bimal	Particulars	Soumya	Bimal		
To Balance c/d	3,00,000	2,00,000	By Balance b/d	3,00,000	2,00,000		
	3,100,000	2,00,000		3,00,000	2,00,000		

Dr		Partners' Current Account				Cr	
Particulars	Soumya	Bimal	Particulars	Soumya	Bimal		
To Drawings	30,000	10,000	By Balance b/d	1,00,000	80,000		
To Interest on Drawings	750	250	By Salary	6,000			
			By Commission		40,000		
To Balance c/d	1,97,650	1,91,350	By Interest on Capital	18,000	12,000		
	2,28,400	2,01,600	By Profit and Loss Appropriation A/c	1,04,400	69,600		
				2,28,400	2,01,600		

2. Soniya, Charu and Smita started a partnership firm on April 1, 2006. They contributed Rs, 5,00,000, Rs. 4,00,000 and Rs. 3,00,000 respectively as their capitals and decided to share profits and losses in the ratio of 3:2:1. The partnership provides that Soniya is to be paid a salary of Rs. 10,000 per month and Charu a commission of Rs. 50,000. It also provides that interest on capital be allowed @6% p.a. The drawings for the year were Soniya Rs. 60,000, Charu Rs. 40,000 and Smita Rs. 20,000. Interest on drawings was charged as Rs. 2,700 on Soniya's drawings, Rs. 1,800 on Charu's drawings and Rs. 900 on Smita's drawings. The net amount of profit as per Profit and Loss Account for the year 2006-07 was Rs. 3,56,600.

(i) Record necessary journal entries.

- (ii) Prepare profit and loss appropriation account  
 (iii) Show capital accounts of the partners.

**Answer**

**Journal Entries**

Date	Particulars	LF	Amt. (Dr)	Amt. (Cr)
(i)	Bank A/c Dr To Soniya's Capital A/c To Charu's Capital A/c To Smita's Capital A/c (Being capital contributed by the partners)		12,00,000	5,00,000 4,00,000 3,00,000
(ii)	Profit and Loss Appropriation A/c Dr To Soniya's Salary To Charu's Commission To Interest on Capital Soniya 30,000 Charu 24,000 Smita 18,000 (Being adjustments made in P & L appropriation account)		2,42,000	1,20,000 50,000 72,000
(iii)	Interest on Drawings A/c Dr To Profit and Loss Appropriation A/c (Being interest on drawings adjusted in P & L appropriation account)		5,400	5,400
(iv)	Profit and Loss Appropriation A/c Dr To Soniya's Capital A/c To Charu's Capital A/c To Smita's Capital A/c (Being profit distributed among partners in 3 : 2 : 1 ratio)		1,20,000	60,000 40,000 20,000

Profit and Loss Appropriation A/c	Dr	3,56,600	
Interest on Drawings A/c	Dr	5,400	
To Soniya's Salary A/c (10,000 × 12)			1,20,000
To Charu's Commission A/c			50,000
To Interest on Capital A/c			72,000
To Partner's Profit A/c			1,20,000
(Being all transactions adjusted in P & L appropriation account)			

Dr **Profit and Loss Appropriation Account** Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Soniya's Salary	1,20,000	By Profit and Loss	3,56,600
To Charu's Commission	50,000	By Interest on Drawings	
To Interest on Capital		Soniya	2,700
Soniya	30,000	Charu	1,800
Charu	24,000	Smita	900
Smita	18,000		5,400
	72,000		
To Profit Transferred to			
Soniya's Capital A/c	60,000		
Charu's Capital A/c	40,000		
Smita's Capital A/c	20,000		
	1,20,000		
	3,62,000		3,62,000

Dr

**Partners' Capital Account**

Cr

Particulars	Soniya	Charu	Smita	Particulars	Soniya	Charu	Smita
To	60,000	40,000	20,000	By Balance b/d	5,00,000	4,00,000	3,00,000
Drawings							
To Interest	2,700	1,800	900	By Salary	1,20,000		
on							
Drawings				By Commission		50,000	
				By Interest on		24,000	18,000
				Capital	30,000		
To Balance	6,47,300	4,72,200	3,17,100	By Profit and		40,000	20,000
c/d				Loss	60,000		
				Appropriation A/c			
	7,10,000	5,14,000	3,38,000		7,10,000	5,14,000	3,38,000

## **EXERCISE-1.2**

### **2 Marks**

1. Raju and Jai commenced business in partnership on April 1, 2006. No partnership agreement was made whether oral or written. They contributed Rs. 4,00,000 and

Rs. 1,00,000 respectively as capitals. In addition, Raju advanced Rs. 2,00,000 as loan to the firm on October 1, 2006. Raju met with an accident on July 1, 2006 and could not attend the business up to September 30, 2006. The profit for the year ended March 31, 2007 amounted to Rs. 50,600. Disputes have arisen between them on sharing the profits of the firm.

Raju Claims:

- (i) He should be given interest at 10% p.a. on capital and so also on loan.
- (ii) Profit should be distributed in the proportion of capitals.

Jai Claims:

- (i) Net profit should be shared equally.
- (ii) He should be allowed remuneration of Rs. 1,000 p.a. during the period of Raju's illness.
- (iii) Interest on capital and loan should be given @ 6% p.a.

State the correct position on each issue as per the provisions of the Partnership Act, 1932.

**Answer** Raju's Claims

- (i) He cannot claim interest on capital and he is entitled only for 6% interest on loan.
- (ii) In absence of any agreement profits are distributed equally

Jai's Claims

- (i) It will be accepted.
- (ii) He is not entitled for any remuneration.
- (iii) No interest on capital is allowed whereas 6% interest for loan should be given.



2. Reena and Raman are partners with capitals of Rs. 3,00,000 and Rs. 1,00,000 respectively. The profit (as per Profit and Loss Account) for the year ended March 31, 2007 was Rs. 1,20,000. Interest on capital is to be allowed at 6% p.a. Raman was entitled to a salary of Rs. 30,000 p.a. The drawings of partners were Rs. 30,000 and 20,000. The interest on drawings to be charged to Reena was Rs. 1,000 and to Raman, Rs. 500.

Assuming that Reena and Raman are equal partners. State their share of profit after necessary appropriations.

<b>Profit and Loss Appropriation Account</b> for the year ending 31 March, 2007			
Dr		Cr	
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Interest Capital		By Profit and Loss	1,20,000
Reena                      18,000		By Interest on Drawings	
Raman                      6,000	24,000	Reena                      1,000	
To Raman's Salary	30,000	Raman                      500	1,500
To Profit Transferred to			
Reena's Capital A/c    33,750			
Raman's Capital A/c   33,750	67,500		
	1,21,500		1,21,500

### TEST YOUR UNDERSTANDING -III

1. Rani and Suman are in partnership with capitals of Rs. 80,000 and Rs. 60,000, respectively. During the year 2006-2007, Rani withdrew Rs. 10,000 from her capital and Suman Rs. 15,000. Profits before charging interest on capital was Rs. 50,000. Rani and Suman shared profits in the ratio of 3:2. Calculate the amounts of interest on their capitals @ 12% p.a. for the year ended March 31, 2007.

Calculation of Opening Capital	Rani	Suman
Closing Capital	80,000	60,000
(+) Drawings	10,000	15,000
(-) Profit Share (50,000 in 3 : 2)	(30,000)	(20,000)
Opening Capital	60,000	55,000

### Interest on Capital

$$\text{Rani} \Rightarrow 60,000 \times \frac{12}{100} = ₹ 7,200 \Rightarrow \text{Suman} \Rightarrow 55,000 \times \frac{12}{100} = ₹ 6,600$$

### Profit and Loss Appropriation Account

Dr

for the year ending 31 March, 2007

Cr

Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Profit Transferred to		By Profit and Loss	1,26,000
Priya's Capital A/c	78,750		
Kajal's Capital A/c	47,250		
	1,26,000		
			1,26,000

2. Priya and Kajal are partners in a firm, sharing profits and losses in the ratio of 5:3. The balance in their fixed capital accounts, on April 1, 2006 were: Priya, Rs. 6,00,000 and Kajal, Rs. 8,00,000. The profit of the firm for the year ended March 31, 2007 is Rs, 1,26,000. Calculate their shares of profits: (a) when there is no agreement in respect of interest on capital, and (b) when there is an agreement that the interest on capital will be allowed @ 12% p.a.

(b)

<b>Profit and Loss Appropriation Account</b> for the year ending 31 March, 2007			
Dr		Cr	
Particulars	Amt. (₹)	Particulars	Amt. (₹)
To Interest on Capital		By Profit and Loss	1,26,000
Priya	54,000		
Kajal	72,000		
	1,26,000		1,26,000

**Note** Interest on capital of partners is in excess of the profit for the year hence proportionate interest will be paid.

### Working Note

Interest on capital (actual)

$$\text{Priya} = 6,00,000 \times \frac{12}{100} = ₹ 72,000$$

$$\text{Kajal} = 8,00,000 \times \frac{12}{100} = ₹ 96,000$$

$$\text{Total interest} = 1,68,000$$

Hence proportionate interest will be calculated

$$\text{Priya} = \frac{72,000}{1,68,000} \times 1,26,000 = ₹ 54,000 ; \text{Kajal} = \frac{96,000}{1,68,000} \times 1,26,000 = ₹ 72,000$$

$$\text{Total} = 1,26,000$$

## DO IT YOURSELF

1. Govind is a partner in a firm. He withdrew the following amounts during the year 2006-07:

DATE	(Rs.)
April 30, 2006	6,000
June 30, 2006	4,000
Sept. 30, 2006	8,000
Dec. 31, 2006	3,000
Jan. 31, 2007	5,000

he interest on drawings is to be charged @ 6% p.a. The books are closed on March 31, every year.

**Interest on Drawings**  
(Product Method)

Date	Amt. (₹)	Period	Product
April 30, 2006	6,000	11	66,000
June 30, 2006	4,000	9	36,000
Sept. 30, 2006	8,000	6	48,000
Dec. 31, 2006	3s,000	3	9,000
Jan 31, 2007	5,000	2	10,000
<b>Total</b>			<b>1,69,000</b>

$$\text{Interest on Drawing} = 1,69,000 \times \frac{6}{100} \times \frac{1}{12} = ₹ 845$$

2. Ram and Syam are partners sharing profits/losses equally. Ram withdrew Rs. 1,000 p.m. regularly on the first day of every month during the year 2006-07 for personal expenses. If interest on drawings is charged @ 5% p.a. Calculate interest on the drawings of Ram.

**Answer** Ram's Drawings =  $1,000 \times 12 = ₹ 12,000$

$$\begin{aligned}\text{Interest on Drawings} &= 12,000 \times \frac{5}{100} \times \frac{6\frac{1}{2}}{12} \\ &= ₹ 325\end{aligned}$$

3. Verma and Kaul are partners in a firm. The partnership agreement provides that interest on drawings should be charged @ 6% p.a. Verma withdraws Rs. 2,000 per month starting from April 01, 2006 to March 31, 2007. Kaul withdrew Rs. 3,000 per quarter, starting from April 01, 2006. Calculate interest on partner's drawings.

**Answer** Drawings during the year

$$\text{Verma} = 2,000 \times 12 = ₹ 24,000$$

$$\text{Kaul} = 3,000 \times 4 = ₹ 12,000$$

Interest on Drawings

$$\begin{aligned}\text{Verma} &= 24,000 \times \frac{6}{100} \times \frac{6\frac{1}{2}}{12} \\ &= ₹ 780\end{aligned}$$

$$\begin{aligned}\text{Kaul} &= 12,000 \times \frac{6}{100} \times \frac{7\frac{1}{2}}{12} \\ &= ₹ 450\end{aligned}$$

**Note** If drawings is done quarterly in a year, then interest on drawings is calculated of  $7\frac{1}{2}$  months.

## DO IT YOURSELF

**Q.1.** Gupta and Sarin are partners in a firm sharing profits in the ratio of 3:2. Their fixed capitals are: Gupta 2,00,000, and Sarin 3,00,000. After the accounts for the year are prepared it is discovered that interest on capital @10% p.a. as provided in the partnership agreement, has not been credited in the capital accounts of partners before distribution of profits. Record adjustment entry to rectify the error.

### Answer

### Journal Entry

Date	Particulars	LF	Amt. (Dr)	Amt. (Cr)
	Gupta's Capital A/c Dr		10,000	
	To Sarin's Capital A/c			10,000
	(Being interest adjusted against profit in capital account)			

### Working Note

#### Statement of Adjustment

		Gupta	Sarin
<b>Amount Already Credited</b>			
Profit Equal to Amount of Interest	A	30,000	20,000
<b>Amount to be Credited</b>			
Interest on Capital	B	20,000	30,000
Difference	(B – A)	(10,000)	(10,000)
		Dr	Cr

**Note** Negative is always debit.

2. Krishna, Sandeep and Karim are partners sharing profits in the ratio of 3:2:1. Their fixed capitals are: Krishan Rs. 1,20,000, Sandeep 90,000 and Karim 60,000. For the year 2006-07, interest was credited to them @ 6% p.a. instead of 5% p.a. Record adjustment entry.

### Journal Entry

Date	Particulars	LF	Amt. (Dr)	Amt. (Cr)
	Karim's Capital A/c Dr		150	
	To Krishna's Capital A/c			150
	(Being difference 1% of interest on capital adjusted)			

### Working Note

#### Statement of Adjustment

		Krishna	Sandeep	Karim	Total
<b>Amount Already Credited</b>					
Interest 1% excess	A	1,200	900	600	2,700
<b>Amount to be Credited</b>					
Profit equal to 1% interest (3 : 2 : 1)	B	1,350	900	450	2,700
Difference	(B – A)	150	—	(150)	
Negative is always debit		Cr		Dr	

3. Leela, Meera and Neha are partners and have omitted interest on capital @9% p.a. for three years ended March 31, 2007. Their fixed capitals on which interest was to be allowed throughout were: Leela Rs. 80,000, Meera Rs. 60,000 and Neha Rs. 1,00,000. Their profit sharing ratio during the last three years were:

Year	Leela	Meera	Neha
2006-07	2	2	2
2005-06	4	5	1
2004-05	1	2	2

Record adjustment entry.

**Answer**

### Journal Entry

Date	Particulars	LF	Amt. (Dr)	Amt. (Cr)
	Meera's Capital A/c Dr		10,440	
	To Leela's Capital A/c			1,440
	To Neha's Capital A/c			9,000
	(Being interest on capital adjusted against capital accounts)			

### Working Note

#### Statement of Adjustment

	Leela	Meera	Neha	Total
<b>Amount Already Credited</b>				
2006-07 Profit equal to interest (2 : 2 : 2)	7,200	7,200	7,200	21,600
2005-06 Profit equal to interest (4 : 5 : 1)	8,640	10,800	2,160	21,600
2004-05 Profit equal to interest (1 : 2 : 2)	4,320	8,640	8,640	21,600
<b>A</b>	<b>20,160</b>	<b>26,640</b>	<b>18,000</b>	<b>64,800</b>
<b>Amount to be Credited</b>				
Interest 2006-07	7,200	5,400	9,000	21,600
2005-06	7,200	5,400	9,000	21,600
2004-05	7,200	5,400	9,000	21,600
<b>B</b>	<b>21,600</b>	<b>16,200</b>	<b>27,000</b>	<b>64,800</b>
Difference (B – A)	1,440	(10,440)	9000	—
	Cr	Dr	Cr	



## **EXERCISE-1.3**

### **4 Marks**

#### **1. Define Partnership Deed.**

**Answer** A partnership deed is a agreement among the partners which contains all the terms of the Partnership. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan etc.

#### **2. Why it is considered desirable to make the partnership agreement in writing?**

**Answer** As per Partnership Act 1932 it is not necessary that a partnership agreement must be in writing but still it is always suggested that it should be in written form. Because today there are very good relationships among the partners but in future if there may be any dispute regarding any issue, a written partnership agreement will help in avoiding disputes and misunderstandings among the partners.

#### **3. List the items which may be debited or credited in capital accounts of the partners when**

**(i) Capitals are fixed**

**(ii) Capitals are fluctuating**

**Answer** (i) When capitals are fixed, the following items will be debited or credited in partners' capital account

### Partners' Capital Account

Date	Particulars	JF	Amt. (₹)	Date	Particulars	JF	Amt. (₹)
	To Bank A/c (Permanent Withdrawal)		–		By Balance b/d (Opening Balance)		–
	To Balance c/d		–		By Bank A/c (Fresh Capital Introduced)		–

(ii) When capitals are fluctuating the following items will be debited or credited in partners capital account.

### Partners' Capital Account

Date	Particulars	JF	Amt. (₹)	Date	Particulars	JF	Amt. (₹)
	To Bank A/c (Permanent Withdrawal)		–		By Balance b/d (Opening Balance)		–
	To Interest on Drawings		–		By Bank A/c (Fresh Capital Introduced)		–
	To P&L Appropriation A/c (Loss on Sharing Basis)		–		By Salaries		–
	To Balance c/d		–		By Interest on Capital		–
					By P&L Appropriation A/c (Profit on Sharing Basis)		–

4. Why is Profit and Loss Adjustment Account prepared? Explain.

**Answer** Profit and loss adjustment account is prepared to record those transaction or omissions and errors which were left while preparing the final accounts and they are found after the final accounts have been prepared and the profits distributed among the partners. The omission may be in respect of interest on capital, interest on drawings, interest on partners' loan, partner's salary, partner's commission or

outstanding expenses.

There may also be some changes in the provisions of partnership deed or system of accountings having impact with retrospective effect. All these acts of omission and commission need adjustments for correction of their impact. These omission errors and corrections can be recorded in partners' capital account directly but still it seems convenient to prepare the profit and loss adjustment account.

**5. Give two circumstances under which the fixed capitals of partners may change.**

**Answer** Under the fixed capital method the capital of partners may change in the following two circumstances

- (i) First, when fresh capital is introduced by the partner with the consent of other partners.
- (ii) Second, when a part of capital is withdrawn by the partner with the consent of other partners.

**6. If a fixed amount is withdrawn on the first day of every quarter, for what period the interest on total amount withdrawn will be calculated?**

**Answer** When fixed amount of money is withdrawn quarterly, it can be withdrawn either at the beginning or at the end of each quarter, if the amount is withdrawn at the end of each quarter, the interest is calculated on the total money withdrawn during the period of seven and half months .

**7. In the absence of partnership deed, specify the rules relating to the following**

- (i) Sharing of profits and losses (ii) Interest on partner's capital**
- (iii) Interest on partner's drawings (iv) Interest on partner's loan**
- (v) Salary to a partner**

**Answer :**(i)Sharing of Profit and Losses

In the absence of partnership deed profit sharing ratio among the pad maw will be equal.

- (ii) Interest on Partner's Capital**

In the absence of paonemnio oeeu interest on partners capital will not be given.

(iii) Interest on Partner's Drawings

In the absence of partnership deed no interest will be charged on partners drawings .

(iv) Interest on Partners Loan

In the absence of partnership deed if partner gives any loan to the firm he/she will be entitled to get fixed percentage of interest @6% of annum.

(v) Salary of Partner

In the absence of the partnership deed a partner will be entitled for getting any salary for his work even if the other are non working.

## **Long Answer Type s**

### **1. What is partnership? What are its chief characteristics? Explain.**

**Answer** According to the Section 4 of the Partnership Act, 1932

Partnership is an agreement between two or more persons who have agreed to share profits or losses of a business that will be carried by all or any one of them acting for all.

Person who joined their hands to set up the business are called 'partners' individually and 'firm' collectively and the name under which they carry out their business is termed as 'firm name'.

The following are the important characteristics of partnership

#### **(i) Two or More Persons**

In order to form partnership, there should be at least two person coming together for a common goal In other words, the minimum number of partners in a firm can be two. There is however, a limit on their maximum number, if a firm is engaged in the banking business, it can have a maximum of ten partners while in case of any other business, the maximum number of partners can be twenty.

#### **(ii) Partnership Deed**

A partnership deed is an agreement among the partners which contains all the terms of the partnership. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan, etc.

#### **(iii) Business**

One of the important characteristics of a partnership is that it is formed to carry out a legal business. Partnership in case of illegal business is not valid.

#### **(iv) Sharing of Profit**

In case of a partnership the partners are suppose to share profit or loss on an agreed ratio or as per the provisions of the Partnership Act, 1932, as per which they will share profit equally.

#### **(v) Liability**

In the case of a partnership liability of partners are unlimited. If there is any

obligation against the third party the partner will have to pay it out of his personal property.

**2. Discuss the main provisions of the Indian Partnership Act, 1932 that are relevant to partnership accounts if there is no partnership deed.**

**Answer** It is always suggested that there must be a partnership deed among the partners before getting into any partnership venture. But sometimes a partnership is started without signing any such document. In this case the rules of partnership will be applicable as per the provisions of the Indian Partnership Act, 1932. The following are the provisions that are relevant to the partnership accounts in absence of partnership deed.

**(i) Profit Sharing Ratio** When a partnership deed is not made or even if it is made and silent on sharing of profit or losses among the partners of a firm, then according to the Partnership Act 1932, profits and losses are to be shared equally among all the partner of the firm.

**(ii) Interest on Capital** When there is absence of partnership deed or the partnership deed is silent on the issue related to interest on partner's capital, then according to the Partnership Act 1932, no interest on partners' capital will be provided. However, if they mutually agree on this issue than they are free to give interest on capital out of the profit of the firm.

**(iii) Interest on Drawings** there is no partnership deed the issue related to interest on drawing will be handled according to the provisions Partnership Act. 1932 According to which no interest on drawing will be charged on the orders on withdraw in the form of drawings.

**(iv) Interest on Partner's Loan** When there is no partnership deed among the partners or the partnership deed is silent on interest on partner's loan then according to the Partnership Act, 1932. the partners are entitled for 6% pa interest on the loan forwarded by them to the firm

**(v) Salary to Partner** When partnership deed is not there or it is silent on the issue related to salary to a partner, then as per the rules of the partnership Act. 1932. no partner will be entitled to any salary.

### **3. Explain why it is considered better to make a partnership agreement in writing.**

**Answer** As per Partnership Act. 1932, it is not necessary that a partnership agreement must be in writing but still it is always suggested that it should be in written form. Because today there are very good relationship among the partners but in future there may be any dispute regarding any Issue a written partnership agreement will help in avoiding disputes and misunderstandings among the partners.

In this way a written partnership deed is more desirable than the oral agreements. A written partnership agreement ensures the smooth functioning of the business of the partnership firm. It also helps in settling the disputes among the partners. Moreover a duly signed and registered partnership deed can be used as evidence in the court of law. Therefore, it is desirable to form partnership deed in writing because of the merits associated with written documents over its oral counterparts.

### **4. Illustrate how interest on drawings will be calculated under various situations.**

**Answer** When a partner withdraws any amount, either in cash or in any other form, from the firm for his/her personal use, then it is termed as drawings. The interest charged by the firm on the amount of drawings is termed as interest on drawings. The method of calculating interest on drawings depends on the information available for time and frequency of the drawings made by the partner. The following different situations of drawings made illustrate the calculation of interest charged on drawings.

**Situation I** When all the information regarding amount, date and rate of interest on drawings is given

When a partner withdrew Rs 10,000 on July 01 and interest on drawings is charged at 12% pa and the firm closed its books on December 31 every year then interest on drawings amount to Rs 600.

$$\text{Interest on drawings} = \frac{\text{Total Amount Drawn} \times \text{Rate of Interest} \times \text{Period}}{100 \times 12}$$

$$\text{Interest on drawings} = 10000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 600$$

**Situation(II)** When information regarding amount, rate of interest on drawings is given

**Case I** Sometimes amount and rate of interest on drawings (per annum) is given but date is not mentioned

in this case when the details regarding the amount of drawings and rate of interest on drawings (pa) is given but the date of drawings is not given then interest will be charged on average basis and the period of drawings will be taken as 6 months

$$\text{Interest on drawings} = 10,000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 600$$

**Case II** Sometimes the amount and rate of interest on drawings is given but the date and per annum rate of interest is not mentioned.

In this case when the date and the rate of interest are given but per annum is not specified, then annual interest is charged.

e.g., If a partner withdrew Rs 10,000 and interest rate is 12%, then the interest on drawings amounts to Rs.12,000.

$$\text{Interest on drawings} = \text{Total Amount withdrawn} \times \frac{\text{Rate}}{100}$$

$$\text{Interest on drawings} = 10,000 \times \frac{12}{100} = ₹ 1,200$$

**Situation III** When a fixed amount is withdrawn at regular interval

**Case I** Sometimes a fixed amount is withdrawn at the beginning of each month and the rate of interest is given then the interest is calculated for 6.5 months.

e.g., If a partner withdraws Rs 1,000 in the beginning of every month and the rate of interest is 12% pa, then the interest on drawings amounts to RS 780.

$$\text{Interest on drawings} = 12,000 \times \frac{12}{100} \times \frac{6.5}{12} = ₹ 780$$

$$\text{Total amount of drawings} = (1,000 \times 12) = ₹ 12,000$$

**Case II** Sometimes a fixed amount is withdrawn at the end of each month and the rate of interest is given then the interest is calculated for 5.5 months.

e.g., if a partner withdraws Rs 1,000 at the end of each month and rate of interest is



12% pa then the interest on drawings amount to Rs 660.

$$\text{Interest on drawings} = \text{Total amount of drawings} \times \frac{\text{Rate}}{100} \times \frac{5.5}{12}$$

$$\text{Interest on drawings} = 12,000 \times \frac{12}{100} \times \frac{5.5}{12} = ₹ 660$$

**Case III** Sometimes a fixed amount is withdrawn at the mid of each month and the rate of interest is given then the interest is calculated for 6 months.

e.g. if a partner withdraws Rs.1,000 on 15th of every month and the rate of interest is 12% pa then the interest on drawings amount to Rs 720.

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

$$\text{Interest on drawings} = 12,000 \times \frac{12}{100} \times \frac{6}{12} = ₹ 720$$

**Case IV** If a fixed amount is withdrawn in the beginning of every quarter then the interest is calculated for 7.5 months.

e.g.. If a partner withdraws Rs.5,000 in the beginning of every quarter and the rate of interest is 12% pa then the interest on drawings amount to Rs 1,800.

$$\text{Interest on drawings} = \text{Total amount of drawings} \times \frac{\text{Rate}}{100} \times \frac{7.5}{12}$$

$$\text{Interest on drawings} = 20,000 \times \frac{12}{100} \times \frac{7.5}{12} = ₹ 1,800$$

$$\text{Total amount of drawings} = 5000 \times 4 = ₹ 20,000$$

**Case V** If a fixed amount is withdrawn at the end of every quarter, then the interest is calculated for 4.5 months.

e.g., If a partner withdraws Rs. 5,000 at the end of every quarter and the rate of interest is 12% pa then the interest on drawings amounts to Rs. 900

$$\text{Interest on drawings} = \text{Total amount of drawings} \times \frac{\text{Rate}}{100} \times \frac{4.5}{12}$$

$$\text{Interest on drawings} = 20,000 \times \frac{12}{100} \times \frac{4.5}{12} = ₹ 900$$

$$\text{Total amount of drawings} = 5000 \times 4 = ₹ 20,000$$

**Situation IV** When different amount is at different intervals

When different amount is withdrawn by a partner at different dates then the interest is calculated by product method. The period of drawings is calculated from the

date of withdrawal to the last date of the accounting year,  
e.g., A partner withdraws Rs.6,000 on March 01, Rs.4,000 on June 01, Rs.5,000 on Aug 30 and Rs.2,000 on Nov 30 and the rate of interest on drawings is 12% pa.  
The firm closes its book on December 31.

#### Calculation of Interest on Drawings by Product Method

Date	Amt. (₹)	Outstanding Period	Product
Mar 01	6,000	10	$6,000 \times 10 = 60,000$
Jun 01	4,000	7	$4,000 \times 7 = 28,000$
Aug 01	5,000	5	$5,000 \times 5 = 25,000$
Nov 30	2,000	1	$2,000 \times 1 = 2,000$
			<u>1,15,000</u>

$$\text{Interest on drawings} = \text{Sum of product} \times \frac{\text{Rate}}{100} \times \frac{1}{12}$$

$$\text{Interest on drawings} = 1,15,000 \times \frac{12}{100} \times \frac{1}{12} = ₹ 1,150$$

#### 5. How will you deal with a change in profit sharing ratio among existing partners? Take imaginary figures to illustrate your answer.

**Answer** Change in the profit sharing ratio occurs only in case of the admission, retirement or death of a partner or sometimes due to the general agreement among the partners in which they may decide to change the profit sharing ratio. There may be number of issues that should be considered during the change in the profit sharing ratio such as goodwill, reserves and accumulated profits, profit or loss on the revaluation of assets and liabilities and adjustment of capital, etc.

As far as the issue related to general reserve is concerned it is basically the accumulated profits (if any) and profit (or loss) on revaluation of assets and liabilities and should be distributed in the partner's capital account in partners old profit sharing ratio.

Sometimes the existing partners may decide to change the profit sharing ratio then some partners gain at the cost of other partners. In other words one partner gain and other one sacrifice equal to the gain. In that case the former should compensate the latter. Therefore, the gaining partner's capital account's are debited to the

extent of their gain and sacrificing partner's capital accounts are credited to the extent of their sacrifice .The following journal entry is passed

Date	Particulars	LF	Amt. (Dr)	Amt. (Cr)
	Gaining Partner's Capital A/c Dr To Sacrificing Partner's Capital A/c (Being adjustment entry passed with the difference figure)			

**Example** Ram. Mohan and Shyam are partners in a firm sharing profit and loss in 3 : 2 : 1 ratio. They decide to share profit and loss equally in future. On dm: date, the books of the firm shows Rs.2,40,000 as general reserve, profit on revaluation of Plant and Machinery Rs.60,000. The following adjustment entry is passed through the capital accounts without affecting the books of accounts.

Particulars	Ram	Mohan	Shyam
Share of Profit as per 3 : 2 : 1	1,20,000	80,000	40,000
Profit on Revaluation of Plant and Machinery	30,000	20,000	10,000
	1,50,000	1,00,000	50,000
Share of Profit as per 1 : 1 : 1	1,00,000	1,00,000	10,000
Difference (Gain or Loss)	50,000 (Loss)	—	50,000 (Gain)

Hence, in the above example. Shyam gains at the cost of Ram. so the Ram needs to be compensated by Shyam with the amount of Rs.50,000. The following

adjustment entry is passed.

Date	Particulars	LF	Amt. (Dr)	Amt. (Cr)
	Shyam's A/c Dr To Ram's Capital A/c (Being adjustment entry passed with the difference figure)		50,000	50,000

### Numerical Type Problems

1. Tripathi and Chauhan are partners in a firm sharing profits and losses in the ratio of 3:2. Their capitals were Rs.60,000 and Rs.40,000 as on January 01, 2005.

During the year they earned a profit of Rs. 30,000. According to the partnership deed both the partners are entitled to Rs. 1,000 per month as Salary and 5% interest on their capital. They are also to be charged an interest of 5% on their drawings, irrespective of the period, which is Rs. 12,000 for Tripathi, Rs. 8,000 for Chauhan. Prepare Partner's Accounts when, capitals are fixed.

**Answer** In case, Interest on capital ,partners salary and interest on drawings is charged against profit.

Dr		Profit and Loss Appropriation Account		Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)	
To Profit Transferred to Tripathi's Current A/c 18,000 Chauhan's Current A/c 12,000	30,000	By Profit and Loss	30,000	
	30,000		30,000	

Dr		Partners' Capital Account				Cr	
Particulars	Tripathi	Chauhan	Particulars	Tripathi	Chauhan		
To Balance c/d	60,000	40,000	By Balance b/d	60,000	40,000		
	60,000	40,000		60,000	40,000		

Dr		Partners' Current Account				Cr	
Particulars	Tripathi	Chauhan	Particulars	Tripathi	Chauhan		
To Drawings	12,000	8,000	By Interest on Capital	3,000	2,000		
To Interest on Drawings	600	400	By Partner's Salary	12,000	12,000		
To Balance c/d	20,400	17,600	By Profit and Loss Appropriation A/c	18,000	12,000		
	33,000	26,000		33,000	26,000		

2. Anubha and Kajal are partners of a firm sharing profits and losses in the ratio of 2:1. Their capital, were Rs.90,000 and Rs.60,000. The profit during the year were Rs. 45,000. According to partnership deed, both partners are allowed salary, Rs. 700 per month to Anubha and Rs. 500 per month to Kajal. Interest allowed on capital @ 5%p.a. The drawings at the end of the period were Rs. 8,500 for Anubha and Rs. 6,500 for Kajal. Interest is to be charged @ 5% p.a. on drawings. Prepare partners capital accounts, assuming that the capital account are fluctuating.

**Answer.** Assuming that partners salary, interest on capital and interest on

drawings have already been adjusted in profit and loss account.

Dr		Profit and Loss Appropriation Account		Cr
Particulars		Amt. (₹)	Particulars	Amt. (₹)
To Profit Transferred to			By Profit and Loss	45,000
Anubha's Capital A/c	30,000			
Kajal's Capital A/c	15,000	45,000		
		45,000		45,000

Dr		Partners' Capital Account		Cr	
Particulars	Anubha	Kajal	Particulars	Anubha	Kajal
To Drawings	8,500	6,500	By Balance B/d	90,000	60,000
To Interest on Drawings	425	325	By Partner's Salary	8,400	6,000
To Balance c/d	1,23,975	77,175	By Interest on Capital	4,500	3,000
			By Profit and Loss Appropriation A/c	30,000	15,000
	1,32,900	84,000		1,32,900	84,000

3. Harshad and Dhiman are in partnership since April 01, 2006. No Partnership agreement was made. They contributed Rs. 4,00,000 and 1,00,000 respectively as capital. In addition, Harshad advanced an amount of Rs. 1,00,000 to the firm, on October 01, 2006. Due to long illness, Harshad could not participate in business activities from August 1, to September 30, 2006. The profits for the year ended March 31, 2006 amounted to Rs. 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 proportion of capital;

Dhiman Claims:

- (i) Profits should be distributed equally;
- (ii) He should be allowed Rs. 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.

**Answer** Decisions according to partnership Act, 1932, if there is no agreement .

Decision on Harshad's Claim

- (i) Interest on partner's capital will not be allowed to partners
- (ii) Profits shall be distributed equally among all the partners

Decision on Dhiman's Claim

- (i) Profits should be distributed equally among all the partners, (ii) No salary shall be allowed to any partner if there is no agreement regarding remuneration.
- (iii) Interest shall be allowed on partner's Loan @ 6% pa whereas no interest is allowed on capital.

Dr		Profit and Loss Appropriation Account		Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)	
To Interest on Partner's Loan		By Profit and Loss	1,80,000	
Harshad $\left(1,00,000 \times \frac{6}{100} \times \frac{6}{12}\right)$	3,000			
To Profit Transferred to				
Harshad's Capital A/c	88,500			
Dhiman's Capital A/c	88,500			
	1,77,000			
	1,80,000			
			1,80,000	

4. Aakriti and Bindu entered into partnership for making garment on April 01, 2006 without any Partnership agreement. They introduced Capitals of Rs. 5,00,000 and Rs. 3,00,000 respectively on October 01, 2006. Aakriti Advanced. Rs. 20,000 by way of loan to the firm without any agreement as to interest. Profit and Loss account for the year ended March 2007 showed profit of Rs. 43,000. Partners could not agree upon the of interest and the basis of division of profit.

You are required to divide the profits between them giving reason for your

solution.

**Answer** In the absence of any agreement between partners

(i) Interest on partners loan is allowed @ 6% pa.

(ii) Interest on capital shall not be allowed.

(iii) Profits are to be distributed equally.

Dr		Profit and Loss Appropriation Account		Cr
Particulars	Amt. (₹)	Particulars	Amt. (₹)	
To Interest on Partner's Loan		By Profit and Loss	43,000	
Aakriti $20,000 \times \frac{6}{100} \times \frac{6}{12}$	600			
To Profit Transferred to				
Aakriti's Capital A/c	21,200			
Bindu's Capital A/c	21,200			
	42,400			
	43,000			
			43,000	