

Objectives

At the end of this chapter, students should be able to:

- Determine net profit;
- Determine partner's share profit.

8.1 Introduction

The trading account and profit and loss account of a partnership business are exactly the same as those of a sole trader's business. However, where a partner loans the business a sum of money, the interest on such loan will be charged to the profit and loss account exactly like any other type of interest and will be credited to the partner's current account. The main difference between partnership accounts and the sole trader accounts is the appropriation accounts.

8.2 Calculation of Net Profit

An appropriation account of a partnership business shows the distribution of the yearly income among the partners according to the agreed policies or provision of the partnership deed. An appropriation account is opened by transferring the Net profit and loss from the profit and loss account to the debit or credit side of the appropriation account. The following entries in the order shown may be required on the debit side, to authorise various appropriations to the partner's current accounts.

These are partnership salaries, interest on capital and residual of profit or loss. On the credit side are net profit transferred from profit and loss account and also interest charged on drawings.

Fig. 8.1: Specimen shows Profit and Loss Appropriation Account

Format

Profit and Loss Appropriation Account

	N		N
Interest on capital	xx	Net profit b/d	xx
A	xx	Interest on drawing	xx
B	xx	A	xx
C	xx	B	xx
Salary		C	xx
A	xx		
B	xx	xx	
C	xx		
Share of profit			
A	XXX		
B	XXX		
C	XXX	xx	
	<hr/> XXX		<hr/> XXX

8.3 Preparation of Partners Share of Profit

To prepare partnership profit and loss appropriation account, the following items must be considered:

1. Interest on Drawings: Where a partner makes a number of drawings from the partnership, it is usual to have interest charged on drawings made by the partners to prevent and reduce unnecessary withdrawal of cash from the business. The interest is calculated from the date of withdrawal to the end of the financial year and debited to the current account.

2. Interest on Capital: The partners may be paid interest on when they have contributed unequal amount. For example; if the partners agreed on 10% interest on capital and Adio contributed N500,000 while Bantu contributed N900,000 such partners will have N50,000 and N90,000 interest income respectively. In such a case, appropriation account will be debited and current accounts will be credited.

3. Salary: If any of the partners are authorised by the partnership deed to draw salary for his efforts in the business, this will have a first claim on the profit after goodwill. This requires a debit to the appropriation account and the same amount credited to such partner's current account.

4. Sharing of Profit: Whatever is left out of the profit and all other earlier deductions are distributed among the partners based on the agreed profit sharing ratio. If there is no agreement, the profit will be shared equally according to the provisions of the Partnership Act of 1890 (Section 24).

Example 8.1

Mazi and Eze enter into partnership on January 1, 2008 agreeing to share profits or loss in the ratio of 3:1. Mazi invested N240,000 and Eze N180,000. It was agreed that because Eze would be in charge of the partnership business, he should be credited with a salary of N15,000. It was also agreed that interest at 5% per annum on capital should be given to each partner before division of profits. The net profit for the year 2008 was N11,000. During the year, Mazi had withdrawn N31,500 and Eze N28,800. Show the appropriation account.

Solution

Profit And Loss Appropriation Account For 31st December 2008

	N	N	N	
Salary Eze		15, 000	Net profit b/d	119, 000
Interest on capital				
Mazi		12, 000		
Eze		9, 000	21, 000	
Share of profits				
Mazi		49, 800		
Eze		33, 200	83, 000	
			<u>119, 000</u>	<u>119, 000</u>

Note:

When a business runs at a loss, the loss will have to be distributed among the partners. We still have to appropriate for goodwill (if any), salaries and interest on capital. Each of these appropriations increases the loss to be shared among the partners in the ratio they share profits or losses.

Example 8.2

If Mazi and Eze in example 8.1 had a net loss of 10,000 instead of 119,000 profit, their appropriation account will be as shown below.

Solution

Profit and Loss Appropriation Account for 31st December 2008

	N	N	N
Net loss b/d		10, 000	
Salary- Eze		15, 000	Share of loss
Interest on capital			Mazi 3/5 of 46,000 27, 600
Mazi		12, 000	Eze 2/5 of 46,000 18, 400
Eze		9, 000	<u>46, 000</u>
			<u>46, 000</u>

8.4 Summary

In this chapter, students have learnt that:

1. Trading, profit and loss accounts of a partnership business are exactly the same as those of a sole trader except that interest is paid on a partner's loan to the business and charged to the profit and loss account.
2. An appropriation account of a partnership business shows the distribution of the yearly income among the partners according to the agreed partnership deeds.
3. The procedures for preparation of account with net profit or net loss in the partners accounts are not the same with sole trader account.

8.5 Revision Questions

1. What is an appropriation account?
2. State the accounting items to be debited and credited in the appropriation account.
3. Explain the following terms:
 - (a) interest on drawings (b) interest on capital
 - (c) partners salary
4. Mazi, Odunsi and Akinleye are in partnership sharing profits in the ratio 4:3:1 respectively. Their capital accounts show credit balance of N50,000, N40,000 and N10,000 respectively.
The partnership agreement provided that:
 - (a) Interest at the rate of 5% per annum is allowed on capital while interest on drawing is 5% per annum.
 - (b) Akinleye should be credited with a salary of N10,000 per annum and Odunsi with N7,500 per annum.
 - (c) Profit before making any adjustments for 31st December 2008 amounted to N49,500. During the year, Abegunde, Odunsi and Akinleye withdraw N10,000, N20,000 and N9,000 respectively.

Prepare the profit and loss appropriation account to show the division between the partners.

5. Sunny, Daniel and Chuks are in partnership. They share profit and loss in the ratio 5:3:2 respectively. The partnership agreement contains the following:

- (a) The partners capitals are: Sunny - N400,000, Daniel - N150,000, Chuks - N250,000.
- (b) Daniel to receive a salary of N60,000 per annum.
- (c) Interest on capital to be 5%.
- (d) Interest on drawing to be 10%.

In 31st December 2007, the net profit was N300,000.

The partner's drawings were as follows:

Sunny N7,000;
Daniel N5,000;
Biodun N3,000.

You are required to prepare the appropriation account for 31st December, 2007.

6. In a partnership business, the net profit serves as opening figure for _____.

- A. trading account
- B. profit and loss account
- C. current account
- D. appropriation account

7. Which of the following is NOT a debit item in the partnership profit or loss appropriation account?

- A. Interest on partner's drawings
- B. Partners salaries
- C. Share of profit
- D. Interest on partner's capital.