Dishaan Commerce Academy
Your Final Destination

DISHAAN COMMERCE ACADEMY

NOTES ON ACCOUNTS
CLASS XII

Presented by
CA AKHIL MITTAL

(A) Definition of Partnership:

It is association of two or more person who agrees to do business and share the profits and losses. As per section 4 of the partnership act, partnership is

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

(B) Features of Partnership:

Following are the features of the partnership:

(a) Association of 2 or more person:
It is association of 2 or more persons who have agreed to do business. The business can be carried on as a company or limited liability partnership.

(b) Agreement:
Partnership comes into existence **eitherin writing ororal,** or not as per the law. The written agreement among the partners is known as **partnership deed.**

(c) Business:
The firm must be engaged in a lawful business. Business includes trade, vocation and profession.

(d) Profit-Sharing:
Profit earned or losses incurred to be distributed among the partners as per partnership deed.

(e) Business to be carried on by all or any one acting for all:
All the partners have equal right to carry on the business. It may also agree upon that some partner may carry on business instead of all.

(C) Provision in absence of Partnership deed:

In absence of Partnership Deed	
Interest on Capital	No interest on capital is to be allowed to any partner.
Interest on Drawings	No interest on drawing is to be charged from any partner.
Salary or commission to a partner	Not Allowed
Interest on Loan by a Partner	Interest is allowed @ 6% per annum.

(D) Profit and loss appropriation account:

P&L appropriation account is prepared after the profit and loss account. This simply depicts the distribution of profits among the partners.

Following is the diagrammatic presentation of **P&L account and appropriation account:**

Profit and Loss account

To Net Profit			

SPECIMEN OF PROFIT AND LOSS APPROPRIATION ACCOUNT

Profit and Loss Appropriation Account

For the year ending on ______________

Dr. Particulars	₹	Particulars	Cr. ₹
To Interest on Capital		By Profit Loss A/c	
A		(Net Profits transferred from	
B		P& L A/c)	
To Partner's Salary/		By Interst on Drawings	
Commission		A	
To Reserves		B	
To Profits transferred to			
capital A/c of :			
A			
B			

Now the Journal entries, starting with the credit side of P&L appropriation account:

(a) For transfer of balance in P&L amount: (Profit transferred)

Profit & Loss account	Dr.	XXX	
Profit & Loss Appropriation account	Cr.		XXX

(b) For Interest on Capital:

Interest on Capital	Dr.	XXX	
To Partners Capital A/c	Cr.		XXX

(Being interest on capital @ allowed)

For Interest on Capital charged to P&L appropriation account:

Profit & Loss Appropriation account	Dr.	XXX	
To Interest on Capital	Cr.		XXX
(Being interest on capital trf. To P&L Appropriation account)			

(c) For salary or commission payable to a partner:

Partner's Salary/Commission A/c	Dr.	XXX	
To Partners Capital A/c	Cr.		XXX
(Being salary/commission payable)			

Profit & Loss Appropriation account	Dr.	XXX	
To Partner's Salary/Commission A/c	Cr.		XXX
(Being salary/commission trf. To P&L appropriation account)			

(d) For transfer of reserve:

Profit & Loss Appropriation account	Dr.	XXX	
To Reserve A/c	Cr.		XXX
(Being reserve created)			

(e) For interest on drawing:

Partner's Capital account	Dr.	XXX	
To Interest on Drawing A/c	Cr.		XXX
(Being interest on drawing charged @___ %p.a.)			

Interest on Drawing A/c	Dr.	XXX	
To Profit & Loss Appropriation account	Cr.		XXX
(Being interest on drawing trf. To P&L appropriation account).			

(f) For transfer of credit balance of profit and loss account appropriation account:

Profit & Loss Appropriation account	Dr.	XXX	
To Partner's Capital account	Cr.		XXX
(Being profit distributed among partners)			

(E) Types of Capital account:

There are mainly 2 types of capital accounts of the partner. These are:

(1) Fixed Capital:

Under this method, 2 accounts are prepared:

- **Partner's Capital account→**

  While preparing the capital account, only two types of transactions are recorded in the capital account:

Additional capital introduced.
Capital withdrawn or drawing out of the capital.

Dr. Partner's Capital A/cs Cr.

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Cash/ Bank A/c (Capital Withdrawn) To Balance c/d (Closing balance)			By Balance b/d (Opening Cr. Balance) By Cash/Bank A/c (Additional Capital Introduced)		

- **Partner's current account→**
  Current account of the partners may have either debit or credit in their current account. All adjustments like interest on capital, interest on drawing, salary or commission payable are done in this account.

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Balance b/d (Opening Dr. Balance) To Drawings (out of Profits) To Interest on Drawings To Profit and Loss A/c (Share in losses) To Balance c/d (Closing credit Balance)			By Balance b/d (Opening Cr. Balance) By Interest on Capital By Partner's Salary or Commission By Profit and Loss Appropriation A/c (Share in Profits) By Balance c/d Closing Dr. Balance		

(2) Fluctuating Capital:

Under this method only 1 account is prepared. It means that only **partner's capital account is prepared and all the adjustments are done in this account.** Consequently the balance in capital account keeps on changing and hence called **fluctuating capital.**

Below is the snap shot of the capital account;

Dr. **Partner's Capital A/cs** **Cr.**

Particulars	X ₹	Y ₹	Particulars	X ₹	Y ₹
To Balance b/d (Opening Dr. Balance)			By Balance b/d (Opening Cr. Balance)		
To Cash/Bank A/c (Capital Withdrawn)			By Cash/ Bank A/c (Additional Capital Intoduced)		
To Drawings (out of profits)			By Interest on Capital		
To Interest on Drawings			By Partner's Salary or Commission		
To Profit and Loss A/c (Share in losses)			By Profit and Loss Appropriation A/c (Share in Profits)		
To Balance c/d (Closing credit Balance)			By Balance c/d (Closing Dr. Balance)		

Now explaining various adjustments one by one:

Salary or commission Payable:

Salary or commission is payable to partners for looking after the business. It is paid only if the **partnership deed allows.**

-- It is appropriation of the profits not a charge against the profits.
-- Normally salary or commission is normally stated in the amount.

Calculation of the salary/commission by 2 methods:

Commission as %age of profits before charging such commission

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

Commission as %age of profits before charging such commission

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

Interest on Partner's Drawings:

Interest on drawings can be calculated by 2 ways→

(a) Simple Method.

Interest on drawing is calculated for separately for each amount of drawing.

$$\text{Interest on drawing} = \text{Drawing Amt.} \times \frac{\text{Rate of Interest}}{100} \times \frac{\text{Months}}{12}$$

(b) Product Method.

Under this method, first of all products are computed by multiplying each set of drawings from its duration.

Interest on drawing = Drawing Amt. X $\frac{\textbf{Rate of Interest}}{\textbf{100}}$ **X** $\frac{\textbf{1}}{\textbf{12}}$

Example for both the methods:

A&B are partners in a firm. During the year ended on 31st March 2011, A makes the drawings as under:

Date of Drawing	Amount (INR)
01-08-2016	☐ 5,000
31-12-2016	☐ 10,000
31-03-2017	☐ 15,000

Partnership Deed provided that partners are to be charged interest on drawings @ 12% p.a. Calculate the interest chargeable to A Drawing by using Simple Interest Method and Product Method.

Solution:

Date of Withdrawal	Amount of Drawing	Months till March 2017	Interest @ 12%	
01-08-2016	5,000	08	400	**SIMPLE INTEREST METHOD**
31-12-2016	10,000	03	300	
31-03-2017	15,000	00	000	
			700	

Date of Withdrawal	Amount of Drawing	Months till March 2017	Product	
01-08-2016	5,000	08	40,000	**PRODUCT METHOD**
31-12-2016	10,000	03	30,000	
31-03-2017	15,000	00	---	
			70,000	

Interest on drawing = 70,000 X $\frac{\textbf{12}}{\textbf{100}}$ **X** $\frac{\textbf{1}}{\textbf{S12}}$ **= 700**

Now there are various scenarios whereby partners may draw amount(s) at different time of the month. To calculate, following formula may be used:

Average Period = $\frac{\text{Months left after } 1^{st} \text{ drawing + Months left after last drawing}}{2}$

Before going forward, let summarize the average period for calculating interest on drawings:

Now applying the formula mentioned in previous page to above table→

Particulars	Amount withdrawn monthly	Amount withdrawn Quarterly	Amount is withdrawn during six months
Drawings made at beginning of each period	**6.5** **(12+1)/2**	**7.5** **(12+3)/2**	**3.5** **(6+1)/2**
Drawings made in the middle of each period	**6** **(11.5+0.5)/2**	**6** **(10.5+1.5)/2**	**3** **(5.5+0.5)/2**
Drawings made at end of each period	**5.5** **(11+0)/2**	**4.5** **(9+0)/2**	**2.5** **(5)/2**

Explaining the case where amount withdrawn at beginning of each month:

Months left after 1st drawing = 12 months
Months left after last drawing = 1 month
So the average period = (12+1)/2 = 6.5 months.

Some points to remember→

(a) If date of withdraw is not given, then **total drawings** to be calculated for 6 months.

(b) In case rate of interest is given without "per annum" then interest is charged without considering the time factor.

For example, A withdraws 2500 per month @ 10%. Here interest on drawing will be ☐ **3,000 (2500*12*10%)**

Calculation of Opening Capital and additional Capital:

Calculation of Opening Capital(Capital is fixed)

Capital at the end of the year Add: **Withdrawal of the capital** Less: **Additional Capital introduced during the year**	**XXX** **XXX** **XXX**
	XXX

Calculation of Closing Capital (Fluctuating Capital)

Capital at the Beginning of the year	**XXX**
Add: **Additional capital introduced.**	**XXX**
Partner's Salary or commission	**XXX**
Interest on capital	
Share of profit	
Less: **Drawings**	**XXX**
Interest on drawings	**XXX**
Share of loss	**XXX**
	XXX

(F) Past adjustments:

After closing of books of accounts, there may be cases where some error or omission is noticed in accounts of earlier years. So the adjustments of these errors are done in current year by following ways:

(a) Passing single adjustment entry:

This can be explained with the help of following example:

Profit and Loss appropriation Account

To share of profit Trf. To:		By profit & Loss account	3,00,000
A 1,00,000			
B 1,00,000			
C 1,00,000			

After the closure, following things were noticed:

- Interest on capital was not allowed amounting to ☐ 12,000, ☐ 9,600 & ☐ 10,500.
- Interest on drawings was not charged ☐ 1,200 (A)& ☐900(B)

Correct P&L appropriation account giving effect to above adjustments.

Solution to the above problem

Profit and Loss appropriation Account

For the year ending __________

To Interest on Capital:		By profit & Loss account	3,00,000
A 12,000		By Interest on Drawings	
B 9,600		A 1,200	
C10,500	32,100	B 900	2,100
To share of profit Trf. To:			
A 90,000			
B 90,000			
C 90,000	2,70,000		
	4,10,000		3,02,100

Particulars	A	B	C
Credited for Interest on Capital	☐ 12,000	☐9,600	☐ 10,500
Debited for Interest on Drawings	(☐ 1,200)	(☐ 900)	---
To be debited for excess profit	(☐ 10,000)	(☐ 10,000)	(☐ 10,000)
Net Effect	**☐ 800**	**(☐ 1,300)**	**☐ 500**

Particular		**Debit (☐)**	**Credit (☐)**
B's Capital account	Dr.	1,300	
To A's Capital account	Cr.		800
To C's Capital account	Cr.		500
(Being adjustment Entry passed for omission of entries)			

(b) Where separate entries to be passed instead of single adjustment entry:

Profit and Loss Adjustment account Dr.
To Partners'Capital/Current account Cr.

(Being the adjustment made forpreviously omitted, now recorded)

Partners' Capital/Current account Dr.
To Profit and Loss Adjustment account Cr.

(Being the adjustment made for previously omitted, now recorded)

Profit and Loss Adjustment account Dr.
To Partners' Capital/Current account Cr.

(Being the profit onadjustment credited to Partners' Capital/Current Accounts)

Partners' Capital/Current account Dr.
To Profit and Loss Adjustment account Cr.

(Being the loss onadjustment transferred to Partners' Capital/Current Accounts)

(G) Guarantee of Profits:

If any new partner is admitted he might be guaranteed some minimum profits from the business. This minimum profit may be guaranteed by

- All the partners.
- One or more of existing or old partners.
- By the firm.

Q.

A &B were partners in a firm sharing profits and losses in the ratio of 3:2. They admit C for 1/6th share in profits and guaranteed that his share of profits will not be less then Rs. 25,000. Total profits of the firm were Rs. 90,000. Calculate share of profits for each partner when:

1. Guarantee is given by firm.
2. Guarantee is given by A
3. Guarantee is given by A and B equally

Case 1: Guarantee is given by firm

To A's Capital (3/5 of ☐ 65,000)	39,000	By profit & Loss account	90,000
To B's Capital (2/5 of ☐ 65,000)	26,000		
To C's Capital (1/6 of 90,000 or 25000 whichever is higher)	25,000		
	90,000		**90,000**

Case 2: Guarantee is given by A

To A's Capital **45,000** (3/6 of ☐ 90,000) **10,000**	35,000	By profit & Loss account	90,000
To B's Capital (2/6 of ☐ 90,000)	30,000		
To C's Capital (1/6 of 90,000) **15,000** **Add: Recover from A** **10,000**	25,000		
	90,000		**90,000**

Case 3: Guarantee is given by A

To A's Capital **45,000** (3/6 of ☐ 90,000) **5,000**	40,000	By profit & Loss account	90,000
To B's Capital **30,000** (2/6 of ☐ 90,000) **5,000**	25,000		
To C's Capital (1/6 of 90,000) **15,000** **Add: From A** **5,000** **from B** **5,000**	25,000		
	90,000		**90,000**