



# 18

## PARTNERSHIP GENERAL

You have already learnt about the sole proprietary business and preparation of its accounts. But, when a business expands, it goes beyond the capacity of one person to provide the capital and manage the affairs of the expanded business. A need is felt to combine his/her efforts and capital with those of another person/persons. This gives rise to the partnership form of organisation.

As far as recording of business transactions in the books of original entry, their posting to ledger and preparing financial statements are concerned there is no difference between a sole proprietor or a partnership firm. But there are certain issues which are specific to partnership firm and require separate accounting treatment. These issues are appropriation of profits of the firm, treatment of goodwill on various occasions and so on. This lesson focuses on such issues related to partnership firms.



### OBJECTIVES

After going through this lesson, you will be able to :

- state the meaning and characteristics of partnership;
- explain the meaning of partnership deed;
- describe accounting treatment of specific issues related to partnership in the absence of partnership deed;
- state the meaning and preparation of capital account;
- distinguish between fluctuating and fixed capital account;
- calculate interest on capital and interest on drawings;
- state the meaning and purpose of Profit and Loss Appropriation account and its preparation.



## Notes

**18.1 PARTNERSHIP AND PARTNERSHIP DEED**

Partnership is a form of business organisation, where two or more persons join hand and start and run a business. They share the profits and losses according to the agreement amongst them.

According to the Indian Partnership, Act 1932,

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

For example, one of your friends has passed class XII from National Institute of Open Schooling (NIOS) and wants to start a business. He/she approaches you to join in this venture. He/she wants you to contribute some money and participate in the business activities. Both of you if join hands, constitute a partnership.

Following are the characteristics of partnership :

- **Agreement**

A partnership is formed by an agreement. The agreement may be either oral or in writing. It defines the relationship between the persons, who agree to carry on business. It may contain the terms of sharing profit and the capital to be invested by each partner, etc. The written agreement is known as partnership deed.

- **Number of persons**

There must be at least two persons to form a partnership. The maximum number of partners in a partnership firm can be ten in case of banking business and twenty in case of non-banking business.

- **Business**

The Partnership is formed to carry on business with a purpose of earning profits. The business should be lawful, Thus, if two or more persons agree to carry on unlawful activities, it will not be termed as partnership.

- **Sharing Profits**

The partners agree to share profits in the agreed ratio. In case of loss, all the partners have to bear it in the same agreed profit sharing ratio.

- **Mutual Agency**

Every partner is an agent of the the other partners. Every partner can bind the firm and all other partners by his/her acts. Each partner will be responsible and liable for the acts of all other partners.



Notes

- **Unlimited liability**

The liability of each partner, except that of a minor, is unlimited. Their liability extends to their personal assets also. If the assets of the firm are insufficient to pay off its debts, the partners' personal property can be used to satisfy the claim of the creditors of the partnership firm.

- **Management**

All the partners have a right to manage the business. However, they may authorize one or more partners to manage the affairs of the business on their behalf.

- **Transferability of share**

No partner can transfer his/her share to any one including his/her family member without the consent of all other partners.

### **Partnership deed**

Agreement forms the basis of partnership. The written form of the agreement is the basis of a document of partnership. It contains terms and conditions regarding the conduct of the business. It also explains relationship amongst the partners. This document is called partnership deed.

Every firm can frame its own partnership deed in which the rights, duties and liabilities of the partners are stated in detail. It helps in settling the disputes arising among the partners in the general conduct of business.

### **Contents of Partnership Deed**

The partnership deed generally contains the following :

- (i) Name and address of the partnership firm;
- (ii) Nature and objectives of the business;
- (iii) Name and address of each partner;
- (iv) Ratio in which profits is to be shared;
- (v) Capital contribution by each partner;
- (vi) Rate of Interest on capital if allowed;
- (vii) Salary or any other remuneration to partners, if allowed;

**Notes**

- (viii) Rate of interest on loans and advances by a partner to the firm;
- (ix) Drawings of partners and interest thereon, if any
- (x) Method of valuation of goodwill and revaluation of assets and liabilities on the reconstitution of the partnership i.e. on the admission, retirement or death of a partner;
- (xi) Settlement of disputes by arbitration;
- (xii) Settlement of accounts at the time of retirement or death of a partner;
- (xiii) Circumstances in which the firm can be dissolved;
- (xiv) Settlement of accounts at the time of dissolution of a firm.

**In the absence of the partnership deed**

The partnership deed lays down the terms and conditions of partnership in regard to right, duties and obligations of the partners. In the absence of partnership deed, there may arise a controversy on certain issues like profit sharing ratio, interest on capital, interest on drawings, interest on loan and salary of the partners. In such cases, the provisions of the Partnership Act becomes applicable:

**(i) Distribution of Profit**

Partners are entitled to share profits equally.

**(ii) Interest on Capital**

Interest on capital is not allowed.

**(iii) Interest on Drawings**

No interest on drawing of the partners is to be charged.

**(iv) Interest on partner's loan**

A Partner is allowed interest @ 6% per annum on the amount of loan given to the firm by him/her.

**(v) Salary and commission to partner**

A partner is not entitled to any salary or commission or any other remuneration for managing the business.

**INTEXT QUESTIONS 18.1****Notes**

- I. Fill in the blanks with appropriate word/words :
- (i) There must be at least ..... persons to form a partnership.
  - (ii) A partnership is formed by .....
  - (iii) Agreement of partnership can be ..... or .....
  - (iv) The written form of agreement of a partnership is called .....
  - (v) The liability of each partner is .....
- II. Asha and Rahul are partners in a firm . If there is no partnership deed, how will you deal with the following? Give your answer in yes or no.
- (i) Asha wants a salary of Rs.3000 per month to be paid to her. Can she claim the salary?
  - (ii) Rahul has advanced a loan to the firm. He claims interest @ 6% p.a. Is it permissible?
  - (iii) Asha and Rahul contribute Rs. 50,000 each as capital. Rahul wants more profit than Asha. Is it permissible?
  - (iv) Asha gets contracts for the firm. She wants 2% commission on the amount of contract. Is she entitled to such commission?
  - (v) Rahul withdraws Rs.500 p.m. for personal use. Asha wants interest to be charged on Rahul's drawings. Can it be charged?

**18.2 CAPITAL ACCOUNT : MEANING AND PREPERATION**

Partners contribute their share of capital in business. These are recorded in their respective accounts named as capital accounts. Suppose there are two partners A and B so there will be A's capital account and B's capital account. These accounts may be maintained in two ways :

**(a) Fixed Capital Account**

In fixed capital account, the closing balance of the capital account is same as that of opening balance except when additional capital is introduced or there is permanent withdrawal during the current accounting year. Items relating to capital account such as interest on capital, interest on drawings and share of profit etc, are recorded in capital account. In this case a separate account is opened for each partner to record these items. This account is



**Notes**

known as ‘current account’. A current account may show a debit or a credit balance. Format of the fixed capital account and the current account is as under :

**Partner’s Capital Account**

Dr.				Cr.			
Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Bank (Permanent withdrawal of Capital)		xxx		Balance b/d (Capital contribution opening balance)		xxx
	Balance c/d (Balance the end)		xxx		Bank (Additional Capital introduced)		xxx
			xxx				xxx

**Partner’s Current Account**

Dr.				Cr.			
Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d (in case of debit opening Balance)		xxx		Balance b/d (in case of credit Opening Balance)		xxx
	Drawings A/c		xxx		Salary		xxx
	Interest on Drawings A/c		xxx		Interest on capital		xxx
	Profit and Loss Appropriation (for share of loss)		xxx		Profit and loss Appropriation (for share of profit)		xxx
	Balance c/d (in case of credit closing balance)		xxx		Balance c/d (in case of debit closing balance)		xxx
			xxx				xxx

**(b) Fluctuating Capital account**

When capital account for each partner is so maintained that in addition to the capital amount other items related to capital account such as interest on capital, drawings, net profit or net loss etc. are written in this account. It is termed as fluctuating capital. In this case there is no need to maintain a separate account for recording of these adjustments.



In the absence of any information, the capital account should be prepared by this method. The format of the fluctuating capital account is as follows:

**Partners' Capital Account**

Dr.				Cr.			
Date	Particulars	JF	Amount (Rs.)	Date	Particulars	JF	Amount (Rs.)
	Balance b/d (in case of Debit opening balance)		xxx		Balance b/d (in case of Credit opening balance)		xxx
	Drawings		xxx		Bank (Additional Capital introduced) A/c		xxx
	Interest on Drawings		xxx		Salaries A/c		xxx
	Profit and Loss Appropriation (for share of loss)		xxx		Profit and Loss Appropriation (for share of profit)		xxx
	Balance c/d (in case of credit closing balance)		xxx		Balance c/d (in case of debit closing balance)		xxx

**Notes**

**Illustration 1**

Rohan and Monika are partners in a firm. Following information is provided as on 31 December, 2006:

	Rohan	Monika
	(Rs.)	(Rs.)
Capital (as on 1.01.2006)	40,000	30,000
Drawings	3,000	2,000
Interest on Capital	2,000	1,500
Interest on Drawings	360	180
Share of Profit	5,000	4,000

Prepare capital account of each partner if capital is :

(a) fixed, (b) fluctuating.



**Notes**

**Solution:**

**(A) Fixed capital account**

**Capital Account**

Dr.					Cr.				
Date	Particulars	JF	Rohan (Rs.)	Monika (Rs.)	Date	Particulars	JF	Rohan (Rs.)	Monika (Rs.)
	Balance c/d		40,000	30,000		Balance b/d		40,000	30,000
								40,000	30,000

**Current Account**

Dr.					Cr.				
Date	Particulars	JF	Rohan (Rs.)	Monika (Rs.)	Date	Particulars	JF	Rohan (Rs.)	Monika (Rs.)
	Drawings		3,000	2,000		Interest on capital		2,000	1,500
	Interest on drawings		360	180		Profit and Loss (Appropriation A/c)		5,000	4,000
	Balance c/d		3,640	3,320					
			7,000	5,500				7,000	5,500
						Balance b/d		3,640	3,320

**(b) Fluctuating capital Account**

**Capital Account**

Dr.					Cr.				
Date	Particulars	JF	Rohan (Rs.)	Monika (Rs.)	Date	Particulars	JF	Rohan (Rs.)	Monika (Rs.)
	Drawings		3,000	2,000		Balance b/d		40,000	30,000
	Interest on drawings		360	180		Interest on capital		2,000	1,500
	Balance c/d		43,640	33,320		Profit & Loss (Appropriation A/c)		5,000	4,000
			47,000	35,500				47,000	35,500
						Balance b/d		43,640	33,320





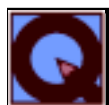
Notes

### Distinction between Fixed and Fluctuating Capital Accounts

The main points of difference between the Fixed and Fluctuating capital accounts are as under:

**Table 17.1 Difference between fixed capital and fluctuating capital accounts**

S. No.	Basis of Distinction	Fixed Capital Account	Fluctuating Capital Account
1.	Number of accounts	Two separate accounts are kept for each partner i.e. 'capital account' and 'current account'.	Only one account for each partner is kept i.e. capital account.
2.	Adjustments	All adjustments are recorded in the current account and not in the capital account.	Adjustments are recorded directly in the capital accounts, as no current account is opened.
3.	Fixed balance	The capital account balance, normally remains, unchanged except under special circumstances.	The balance of the capital account fluctuates from period to period.
4.	Balance	Capital accounts always show a credit balance only.	The capital account can show a debit balance or a credit balance at the end of the period.



### INTEXT QUESTION 18.2

Fill in the blanks with suitable word/words :

- (i) Fixed Capital account always show ..... balance only.
- (ii) A ..... capital account may show a debit or a credit balance.
- (iii) Two separate accounts are kept for each partner, if capital is .....
- (iv) Interest on capital is shown on the ..... side of the current account.
- (v) Interest on drawings is shown on the ..... side of the current account.

### 18.3 ACCOUNTING TREATMENT OF INTEREST ON CAPITAL AND INTEREST ON DRAWINGS

#### Interest on capital

Let us now study about calculation of interest on capital. As you know that, interest on capital is allowed when it is provided in the Partnership Deed.



**Notes**

If it is so provided, the rate of interest will be as agreed upon by the partners. Interest is charged on the opening balance of the partner’s capital account. When additional capital is introduced and some capital is withdrawn permanently, the interest will be calculated on the amount of the capital used in the business during a particular period. Interest is treated as an expense as it is a charge on the profits of the firm. The following journal entry will be made:

For Interest on Capital

Interest on Capital A/c	Dr.
To Partner’s Capital A/c (Individually)	
(Crediting Interest on Capital to Capital Account)	

Interest can be calculated directly i.e. simple interest is to be calculated by taking the principal amount, period and rate of interest. Alternately interest can be calculated by product method i.e. by converting the principal amount into monthly products depending upon number of months for which principal amount remained in business. Then the interest is calculated by taking monthly rate of interest. The following example will illustrate both the methods of calculating interest on capital.

**Illustration 2**

Shilpa and Sanju are partners with a capital of Rs.1,00,000 and Rs.1,60,000 on January 1,2006 respectively. Shilpa introduced additional capital of Rs.30,000 on July 1, 2006 and another Rs.20,000 on October 31,2006. Calculate interest on capital for the year ending 2006. The rate of interest is 9% p.a.

**Solution:**

**Interest on Capital (Shilpa):**

On Rs.1,00,000 for 12 month @ 9%	= $1,00,000 \times \frac{9}{100} \times \frac{12}{12}$
	= Rs. 9,000
On Rs.30,000 for 6 month @ 9%	= $30,000 \times \frac{9}{100} \times \frac{6}{12}$
	= Rs. 1,350
On Rs.20,000 for 2 month @ 9%	= $20,000 \times \frac{9}{100} \times \frac{2}{12}$
	= Rs.300
Total interest on shilpa capital	= Rs. 9,000 + Rs. 1350 + Rs. 300
	= Rs.10,650



By product method

Amount Rs	Months	Product
100000	12	1200000
30000	6	180000
20000	2	40000
Total product		1420000

Notes

$$\text{Interest on capital } 1420000 \times \frac{9}{100} \times \frac{1}{12}$$

$$= \text{Rs } 10650$$

**Interest on Capital (Sanju):**

$$\begin{aligned} \text{On Rs.1,60,000 for 12 month @ 9\%} &= 1,60,000 \times 9/100 \times 12/12 \\ &= \text{Rs.14,400} \end{aligned}$$

$$\begin{aligned} \text{By product method :} &= 1,60,000 \times 12 = 19,20,000 \\ &= \frac{19,20,000 \times 9}{1200} = \text{Rs } 14,400 \end{aligned}$$

**INTEREST ON DRAWINGS**

When a partner withdraws cash from the firm for domestic use, the withdrawal of cash is termed as drawings. If the partnership deed has a provision of charging interest on drawings, the firm may charge interest on drawings from partners. Interest on drawing is a gain for the firm. It is calculated at the agreed rate. The amount of interest on drawings will be credited to Profit and Loss Appropriation Account and will be debited to partner's capital account/current account (Individually). The journal entry will be:

Partners Capital/Current A/c	Dr.
To Interest on Drawings A/c	
(Charging interest on drawings to Partner's Capital account)	

**Calculation of interest on Drawings :**

There are two methods of calculating interest on drawings

- Simple Average method
- Product method



**Notes**

**1. Simple Average method**

A fixed amount may be withdrawn every month/ half yearly/ annually. The interest has to be calculated for the period for which the amount has been utilised for personal purposes by the partners. The calculation of amount of interest to be charged in different situations is shown as under :

**I. When Fixed amounts are withdrawn at equal time intervals.**

A fixed amount is withdrawn by the partners, at equal time interval, say each month or each quarter. The calculation of total time period, in such situations will depend upon whether the money was withdrawn at the beginning of the month, middle of the month or at the end of the month.

For example, Manisha withdrew Rs. 1,000 per month from the firm for her personal use during the year ending December 31, 2006. interest is charged at the rate of 12% per annum. The calculation of average period and the interest on drawings in different situations would be as follows:

**(a) When money is withdrawn at the beginning of the period.**

Date of drawings	Amount withdrawn	Period (in Month)
1 January 2006	1,000	12
1 February 2006	1,000	11
1 March 2006	1,000	10
1 April 2006	1,000	9
1 May 2006	1,000	8
1 June 2006	1,000	7
1 July 2006	1,000	6
1 August 2006	1,000	5
1 September 2006	1,000	4
1 October 2006	1,000	3
1 November 2006	1,000	2
1 December 2006	1,000	1
	12,000	78 months



When money is withdrawn in the beginning of the month, the average period is calculated as under:

$$\begin{aligned} \text{Average Period} &= \text{Total of months}/12 \\ &= 78\text{months}/12 \\ &= 6\frac{1}{2} \text{ months} \end{aligned}$$

$$\begin{aligned} \text{Interest on Drawings} &= \text{Rs.} \\ &= \text{Rs.780} \end{aligned}$$

**Notes**

**(b) When money is withdrawn at the end of the period**

Date of drawings	Amount withdrawn	Period (in Month)
31 January 2006	1,000	11
28/29 February 2006	1,000	10
31 March 2006	1,000	9
30 April 2006	1,000	$12,000 \times \frac{12}{100} \times \frac{8}{2} \times \frac{1}{12}$
31 May 2006	1,000	
30 June 2006	1,000	6
31 July 2006	1,000	5
31 August 2006	1,000	4
30 September 2006	1,000	3
31 October 2006	1,000	2
30 November 2006	1,000	1
31 December 2006	1,000	0
	12,000	66 months

When money is withdrawn at the end of the month, the average period is calculated as under:

$$\begin{aligned} \text{Average Period} &= \text{Total of months}/12 \\ &= 66 \text{ months}/12 \end{aligned}$$



**Notes**

$$= 5 \frac{1}{2} \text{ months}$$

$$\begin{aligned} \text{Interest on Drawings} &= \text{Rs.}12,000 \times \frac{12}{100} \times \frac{11}{2} \times \frac{1}{12} \\ &= \text{Rs.}660 \end{aligned}$$

(c) When money is withdrawn in the middle of the month:

<b>Date of drawings</b>	<b>Amount withdrawn</b>	<b>Period (in Month)</b>
15 January 2006	1,000	11.5
14 February 2006	1,000	10.5
15 March 2006	1,000	9.5
15 April 2006	1,000	8.5
15 May 2006	1,000	7.5
15 June 2006	1,000	6.5
15 July 2006	1,000	5.5
15 August 2006	1,000	4.5
15 September 2006	1,000	3.5
15 October 2006	1,000	2.5
15 November 2006	1,000	1.5
15 December 2006	1,000	0.5
	12,000	72 months

When money is withdrawn in the middle of the month, the average period is calculated as under:

$$\begin{aligned} \text{Average Period} &= \text{Total of months}/12 \\ &= 72 \text{ months}/12 \\ &= 6 \text{ months} \end{aligned}$$

$$\begin{aligned} \text{Interest on Drawings} &= \text{Rs.}12,000 \times \frac{12}{100} \times \frac{6}{12} \\ &= \text{Rs.}720 \end{aligned}$$

**(d) withdrawal of Fixed amounts at equal time intervals**

If the money is withdrawn by the partners in the beginning of each quarter, the interest is calculated on total money withdrawn during the year for an average period of seven and half months.



Notes

**Illustration 3**

Sunny and Himanshu are partners in a firm sharing profits and losses equally. During financial year 2006, Sunny withdrew Rs. 20,000 quarterly at the beginning of each quarter. If interest is to be charged on drawings @ 8% per annum, calculate the amount of interest to be charged at the end of the year.

**Solution.****Statement showing calculation of interest on Drawings**

Date	Amount (Rs.)	Time Period	Interest (Rs.)
Jan. 1, 2006	20,000	12 months	$20,000 \times \frac{8}{100} \times 12 = \text{Rs. } 1,600$
April 1, 2006	20,000	9 months	$20,000 \times \frac{8}{100} \times 9 = \text{Rs. } 1,200$
July 1, 2006	20,000	6 months	$20,000 \times \frac{8}{100} \times \frac{6}{12} = \text{Rs. } 800$
Oct. 1, 2006	20,000	3 months	$20,000 \times \frac{8}{100} \times \frac{3}{12} = \text{Rs. } 400$
Total	80,000		= Rs. 4,000

Alternatively, the interest can be calculated on the total sum withdrawn during the accounting year, which is Rs. 80,000 in this case, for a period

of  $7\frac{1}{2}$  months  $(12 + 9 + 6 + 3)/4 = 7\frac{1}{2} = \frac{15}{2}$

Thus Interest on Drawings = Total sum withdrawn  $\times$  Rate  $\times$   $7\frac{1}{2} \times \frac{1}{12}$

$$= \text{Rs. } 80,000 \times \frac{8}{100} \times \frac{15}{2} \times \frac{1}{12} = \text{Rs. } 4,000.$$

**(e) When fixed amount is withdrawn at the end of each quarter**

When the amounts are withdrawn at the end of each quarter the amount of interest is calculated on total drawings for a period of four and a half months.



**Notes**

In the previous illustration, if the money is withdrawn at the end of each quarter, the average period for calculation of interest will be taken as four and half months. The calculation of interest can be shown as follows:

**Statement of Calculation of Interest on Drawings**

Date	Amount (Rs.)	Time Period	Interest (Rs.)
March. 31	20,000	9 months	$20,000 \times \frac{8}{100} \times 9/12 = \text{Rs. } 1,200$
June 30	20,000	6 months	$20,000 \times \frac{8}{100} \times 6/12 = \text{Rs. } 800$
September 30	20,000	3 months	$20,000 \times \frac{8}{100} \times 3/12 = \text{Rs. } 400$
December 31	20,000	0 months	Rs 0
<b>Total</b>	<b>80,000</b>	<b>18 months</b>	<b>= Rs. 2,400</b>

Alternatively, the interest on  $\frac{6}{12} \times \frac{8}{100}$  RS. 80,000 for a period  $4\frac{1}{2}$  months

$$(9 + 6 + 3 + 0)/4 = 4\frac{1}{2} = \frac{9}{2}$$

$$\text{Interest on Drawings} = \text{Rs. } 80,000 \times \frac{8}{100} \times \frac{9}{2} \times \frac{1}{12} = \text{Rs. } 2,400$$

**Product Method**

**When different amounts are withdrawn at different intervals.**

Under the product method, for each withdrawal, the money withdrawn is multiplied by the period for which it remained withdrawn during the financial year. The period is calculated from the date of the withdrawal to the last day of the accounting year. The products so calculated are totalled and interest for 1 month at the specified rate is found out on the total of the products. The calculation of interest can be explained with the help of the preceding illustration.



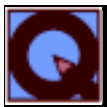


### Statement showing calculation of interest on Drawings

Date	Amount (Rs.)	Time Period	Product (Rs.)
Jan. 1, 2006	20,000	12 months	2,40,000
April 1, 2006	20,000	9 months	1,80,000
July 1, 2006	20,000	6 months	1,20,000
Oct. 1, 2006	20,000	3 months	60,000
Total	80,000		6,00,000

$$\begin{aligned}
 \text{Interest on drawing} &= \text{Total of Product} \times \text{interest rate} \times 1/12 \\
 &= \text{Rs.}6,00,000 \times 8/100 \times 1/12 \\
 &= \text{Rs.}4,000
 \end{aligned}$$

Notes



### INTEXT QUESTIONS 18.3

- Fill in the blanks with appropriate word/words :
  - Interest on capital is ..... in partner's capital account.
  - Interest on drawings is ..... in partner's capital account.
  - Interest is charged on the ..... of the partner's capital account.
  - When money is withdrawn in the beginning of the each month, the average period is ..... for charging interest.
  - When product method is used, interest is calculated for .....
- Reema and Anish are partners with a capital of Rs 50,000 and Rs. 80,000 on April 2005, respectively. Reema introduced additional capital of Rs. 50,000 on 1st Jan 2006. Calculate interest on capital @10 p.a. on March 31, 2006.
- Ashu withdrew Rs. 2000 p.m. from business for personal use at the end of every month during the year. Calculate interest on Drawing @10 p.a.

### 18.4 PROFIT AND LOSS APPROPRIATION ACCOUNT: MEANING AND PREPARATION

Profit and Loss Appropriation Account is merely an extension of the Profit and Loss Account of the firm. The profit of the firm has to be distributed



**Notes**

amongst the partners in their respective profit sharing ratio. But before its distribution it needs to be adjusted. All Adjustments like partner's salary, partner's commission, interest on capital, interest on drawings etc. are made in this account. These adjustments will reduce the amount of profit for distribution. This adjusted profit will be distributed amongst the partners in their profit sharing ratio. To prepare it at first the balance of Profit and Loss Account is transferred to this account. The journal entries for the preparation of Profit and Loss Appropriation Account are given below:

1. For transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account.

(a) In case of Net Profit:

Profit and Loss A/c	Dr.
To Profit and Loss Appropriation A/c	
(Net Profit transferred to Profit and Loss Appropriation A/c)	

(b) In case of Net Loss:

Profit and Loss Appropriation A/c	Dr.
To Profit and Loss A/c	
(Net Loss transferred to Profit and Loss Appropriation A/c)	

2. For Interest on Capital

For transfer of Interest on Capital :

Profit and Loss Appropriation A/c	Dr.
To Interest on Capital A/c	
(Interest on capital transferred to Profit & Loss Appropriation A/c)	

3. For Charging Interest on Drawings:

For transferring Interest on Drawings:

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

4. For Partner's Salary

Profit and Loss Appropriation A/c	Dr.
To Salary A/c	
(Salary transferred to profit & Loss Appropriation A/c)	





**Notes**

**Illustration 5**

Monika and Krishan are partners with a capital of Rs.80,000 and Rs.1,00,000 respectively. They agree on the followings:

- (a) To share profit equally.
- (b) Interest allowed on capital @ 9% p.a.
- (c) Interest charged on drawing @ 6% p.a.
- (d) Salary to be paid to krishan @ 600 per month.
- (e) Monika withdrew Rs.8,000 and Krishan Rs.6,000 during the year.

Interest on drawing is charged for Profit for the year ending December 31, 2006 is Rs.56,000. You are required to prepare Profit and Loss Appropriation account.

**Solution**

**Working notes:**

First you should calculate the interest on capital and the interest on drawings.

**Interest on Capital**

$$\begin{aligned} \text{Monika} &= \text{Rs. } 80,000 \times 9/100 \\ &= \text{Rs. } 7,200 \end{aligned}$$

$$\begin{aligned} \text{Krishan} &= \text{Rs. } 1,00,000 \times 9/100 \\ &= \text{Rs. } 9,000 \end{aligned}$$

**Interest on Drawings**

$$\text{Monika Drawings} = \text{Rs. } 8,000$$

$$\begin{aligned} \text{Interest} &= \text{Rs. } 8,000 \times 6/100 \\ &= \text{Rs. } 480 \end{aligned}$$

$$\text{Krishan Drawings} = \text{Rs. } 6,000$$

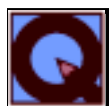
$$\begin{aligned} \text{Interest} &= \text{Rs. } 6,000 \times 6/100 \\ &= \text{Rs. } 360 \end{aligned}$$



### Profit and Loss Appropriation Account

Dr.		Cr.	
Particulars	Amount (Rs.)	Particulars	Amount (Rs.)
Interest on Capital's A/c		Profit and Loss	56,000
Monika       7,200		Interest on Drawings	
Krishan      9,000	16,200	Monika       480	
Krishan Salary	7,200	Krishan      360	840
Profit transferred to Partners' Capital A/c			
Monika      16,720			
Krishan     16,720	33,440		
	<b>56,840</b>		<b>56,840</b>

### Notes



### INTEXT QUESTIONS 18.4

- List the items which usually appear on the debit side of Profit and loss appropriation account.
- If, balance of profit and loss account is debit, what entry to be recorded for transferring the amount to Profit and Loss Appropriation account?
- When interest on drawings is to be transferred to Profit and Loss Appropriation account, What journal entry is to be recorded in the books?



### WHAT YOU HAVE LEARNT

- Characteristics of partnership are:
  - Agreement
  - Number of persons
  - Business
  - Sharing of Profits
  - Unlimited liability
  - Management
  - Mutual Agency
  - Transfer of interest



**Notes**

● **Partnership deed**

The written form of the agreement is a document in which the terms and conditions regarding the conduct of the business and the relationship between the partners are laid down. If there is no partnership deed or it is silent on certain issues, the Partnership Act becomes applicable. These issues are:

- (i) Distribution of Profit
- (ii) Interest on capital
- (iii) Interest on drawings
- (iv) Interest on partner's loan
- (v) Salary and commission to partners

● **Capital account**

The contribution made by the partner's in a business is called capital. This capital may be fixed or fluctuating.

- (a) Fixed Capital Account- Two separate accounts are kept for each partner i.e. 'capital account' and 'current account'.
- (b) Fluctuating Capital Account – Only one account for each partner is kept i.e. capital account,

● **Profit and Loss Appropriation Account**

All adjustments such as partner's salary, partner's commission, interest on capital, interest on drawings etc. are made through this account.



**TERMINAL QUESTIONS**

1. Explain the characteristics of a partnership.
2. In absence of any partnership deed, what is the partnership Act that are the provisions that become applicable?
3. Distinguish between fixed and fluctuating capital accounts.
4. Why the Profit and Loss Appropriation is prepared?
5. A and B are partners in a firm. On January 1, 2006 their capital is Rs.3,00,000 and Rs.2,00,000 respectively. Their drawings during the year were Rs.3,000 per month each. They allowed 6% interest on capital. The profit for the year Rs.4,00,000. Calculate interest on capital when capital are fixed.
7. X and Y are equal partners. They withdrew Rs.4,000 each per month. Calculate interest 4% p.a. on drawing in the following cases:



## Notes

- (i) if they withdrew in the beginning of each month:
- (ii) if they withdrew at the end of each month:
- (iii) if they withdrew in the middle of each month:

8. Naman and Asmeta started business with capital of 1,00,000 each on January 1, 2006. their drawings during the year were Rs.1,000 and Rs.500 per month respectively. The interest on drawing was Rs.200 and Rs.100 respectively. They are allowed interest on capital at 8% p.a. Naman is allowed a salary of Rs.2,000 per month. They earned a profit of Rs.94,000 before interest and salary. They share profit in the ratio of 2:1.

Prepare Profit and Loss Appropriation Account and Capital accounts of partners.

9. Rohan and Bhanu were partners in a firm and their balances on March 1, 2006 are as under:

	Rohan (Rs.)	Bhanu (Rs.)
Capital accounts	90,000	1,20,000
Current account	8,000 (Cr)	4,000 (Dr.)
Drawings	5,000	6,000

Net profit before charging interest on capital and partners salary was Rs.25,600. They agree on the following:

- (i) Profit and losses to be shared equally.
- (ii) 6% interest is to be allowed on capital.
- (ii) Bhanu will be paid a monthly salary Rs. 9,00.

Prepare Profit and Loss Appropriation Account and partners capital accounts.

10. The partnership agreement of M and R provides that:

- (i) Profit will be shared in the ratio of 3 : 2.
- (ii) M will be allowed a salary of Rs.500 p.m.
- (iii) 8% interest will be allowed on partner's fixed capital accounts.
- (iv) 6 % interest to be charged on partners drawings.
- (v) The fixed capital of M and R is Rs.2,00,000 and Rs.1,50,000 respectively. Their drawings were Rs.10,000 and Rs.12,000 respectively. The net profit for the year ending December 2006 amounted to Rs.62,000.

Prepare Profit and Loss Appropriation Account.



Notes



**ANSWERS TO INTEXT QUESTIONS**

**Intext Questions 18.1**

- I. (i) Two (ii) agreement (iii) written, oral  
 (iv) partnership deed (v) unlimited
- II. (i) No (ii) Yes (iii) No  
 (iv) No (v) No

**Intext Questions 18.2**

- (i) Credit (ii) Current (iii) fixed  
 (iv) Credit (v) Debit

**Intext Questions 18.3**

1. (i) credited (ii) Debited (iii) pening balance  
 (iv) 6½ months (v) month
2. Interest on capital Reema Rs 6250 and Anish Rs 8,000
3. Interest on Rs. 1100 drawing

**Intext Questions 18.4**

- (i) Partner's salary, partner's commission, interest on capital, interest on partners loan
- (ii) Profit and Loss Appropriation A/c Dr.  
 To Profit and Loss A/c
- (iii) Interest on Drawings A/c Dr.  
 To Profit and Loss Appropriation A/c

**Answers to Practical Terminal Questions**

5. Interest on Capital to 'A' Rs.18,000 and 'B' Rs.12,000.
6. (i) Rs.1,040, (ii) Rs.880, (iii) Rs.960.





7. Profit distributed to Naman Rs.36,200 and Asmeta Rs.18,100  
Balance in Capital A/c Naman Rs.1,56,00 and Asmeta Rs.1,20,000.
8. Profit distributed to Rohan Rs.1,100 and Bhanu Rs.1,100  
Balance in current A/c Rohan Rs.9,500 and Asmeta Rs.9,100.
9. Profit distributed to M Rs.17,592 and R Rs.11,728

**Notes**



**Activity :** Make use of your communication skills to obtain Partnership Deed of five firms. Go through partnership deed of such firms. Identify the provisions which are not common. Also find out the important items that you would like to include in one of the partnership deeds.

Name of the firm	Items that are exclusive to the firm	Items to be included
1.		
2.		
3.		
4.		
5.		

List of the item you suggest to included in partnership deeds

1. ....
2. ....
3. ....
4. ....
5. ....

**Do you know?**



**Can a person get AIDS from a dentist?**

Again, there is some risk of getting HIV from a dentist's instruments as these are frequently contaminated with blood. However, if you visit a good and reputable dentist who uses properly sterilized or disposable instruments, the risk is minimal. So always choose a dentist who follows high levels of hygiene and sterilization.