

1. Accounting For Partnership Firms: Fundamentals

Introduction

Partnership is an agreement between two or more persons, of running a business and sharing its profit and losses. The right and duties of partners are decided through mutual agreement and in absence of such an agreement the provisions of Indian partnership Act 1932 are applicable. Partnership is a relation of mutual trust and faith. Partnership accounts should present a true and fair picture of the partnership business. Partnership is governed by the "Indian Partnership Act 1932"

***Definition: -**

When two or more persons enter in to agreement for setting up a business, to run it and share the profit and losses, it is termed as partnership

"According to partnership act 1932, as per section 4,

Partnership is the relationship between persons who have agreed to share the profits of a business. Carried on by all or any of them acting for all

This definition highlights following elements

There must be two or more persons.

There must be an agreement...

There must be sharing of profits of business.

There must be a mutual agency, i.e., the business must be either carried on by all or any of them acting for all.

*** Characteristics of partnership**

Following are the essential features or characteristics of partnership:

1. Two or more persons: According to Indian partnership act 1932 minimum two persons are required to form partnership. Under Indian partnership Act 1932 no rule has been provided in respect of the maximum number of partners. But section 464 of Indian companies Act 2013, restricts the maximum number of partners to 100

But as per rule 10 of company Rules 2014 the maximum number of partners in a firm shall be 50. Hence is present the maximum limit of 50 partners shall be considered.

2. Agreement: Generally, partnership business is formed under agreement between the partners. this agreement may be oral, Written or implied. The agreement forms the basis of mutual rights and duties of partners.

3. Lawful Business: A partnership is formed to do a lawful business which includes trade, vocation and profession. For a partnership there has to be a business and the business should be legal. Any type of charitable institution running as a not-for-profit organization will not be considered as a business.

4. Profit-Sharing: A partnership agreement specifies how the profits and losses of the firm will be shared by the partners. Profit of a partnership firm are distributed among its partners in a fixed ratio

5. Unlimited LIABILITY: - The liability of all the partners of a firm is unlimited like the sole proprietorship. If the assets of the partnership firm are less than its liabilities, firm liabilities can be paid off from personal assets of the partner.

6. No separate Entity: -partnership does not have a separate entity from its partners.

7. Mutual Agency: - Business can be carried on by all or any of the Partners Acting for All: Since, the partners are the agents as well as principals of the firm; such business of the partnership firm can be carried on by all or any of the partners acting for all that is there must be mutual agency

8. No Transfer of interest without consent: - A partner cannot transfer his interest in the firm without the consent of all other partners.

Rights of Partners:

Every Partner has the right:

1. To participate in the management of the business.
2. To be consulted about the affairs of the business.
3. To inspect the books of account and have a copy of it.
4. To share profits and losses with others in the agreed ratio.
5. To receive interest on the loan advanced by him to the firm at an agreed rate of interest. Where the rate is not agreed, interest is paid at the rate of 6% p.a. As per the provisions of Indian partnership act, 1932.
6. To act according to his best judgment in case of emergency and be indemnified for the expenses incurred by him.
7. To retire from the firm after giving proper notice for the same.
8. To get indemnified against the expenses incurred by him on the business or incurred by him on behalf of the firm.

Kind of Partnership

1.On the basis of liability

(a) Limited partnership: - when the liability of any partner is limited to the extent of share in profit and the invested amount as capital. The personal assets of partner are not used for payment of debts.

(b) Unlimited partnership: - when the liability of all partners is un- limited in the favor of creditors. the personal assets of partners may be used for payment of debts.

2.On the basis of Object (Purpose)

(a) Partnership as Will: - when the partnership starts for Indefinitely for any business

(b) Particulars (specific) partnership: - When the partnership starts for any specific purpose and work. When specific work completed then it ends automatically

3. On the basis of Time(term)

(a)Fixed term partnership: - when the partnership starts for fixed period (like 6 months, 5 years etc)

(b)None fixed partnership: - When the partnerships starts for indefinitely period and not have any specific objects.

4. On the basis of legality

(a)Registered partnership: - When the partnership is registered by Indian partnership act 1932

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(b) Legal partnership: - When the partnership business running according to Indian partnership act 1932 and follows rules of act

(C) Illegal partnership: - When the partnership business is not running according to Indian partnership act 1932 and not follows rules of act

Important definitions

Partner: - The persons who have entered in to partnership with one another individually, are called partner

Firm: - The group of partners which the business is carried on is called firm

Firm Name: - The name under which the business of the partners is carried on is called the Firm Name

Partnership Business: - A partnership is a form of business where two or more people share ownership as well as the responsibilities for managing the business and the income or losses the business generates to be called partnership business

Types of Partner: - Generally, There are two types of the partner

(a) Active partner: A partner who contributes capital and takes an active part in the management of the partnership.

(b) Sleeping partner: A partner who merely contributes capital for the business but does not take part in the management of the partnership business

***Partnership Deed:** Partnership Deed is a written agreement among the partners of a partnership firm. It includes agreement on profit sharing ratio, salaries, commission of partners, interest provided on partner's capital and drawings and interest on loan given or taken by the partners, etc. Other word, it is a written document containing the terms of agreement between the partners pertaining to the rights, duties and obligation of the partner. It is also known as Articles of partnership.

Partnership agreement may be oral or written. It is not compulsory to form partnership agreement in writing under the Partnership Act, 1932. However, written partnership deed is desirable than oral agreement as it helps in avoiding disputes and misunderstandings among the partners. Also, it helps in settling disputes (as the case may be) among the partners, as written partnership deed can be referred to anytime. If written partnership deed is duly signed and registered under Partnership Act, then it can be used as evidence in the court of law.

A written document containing the terms and conditions of partnership and because of which the partnership comes into existence is known as Partnership Deed. It is a legal document signed by all the partners and has the following clauses:

- i. **Description of the Partners:** It contains names, description and addresses of the partners.
- ii. **Description of the Firm:** It contains name and address of the firm.
- iii. **Principal Place of Business:** It contains address of the principal place of business.
- iv. **Nature of Business:** It specifies the nature of business that the firm shall carry on.
- v. **Commencement of Partnership:** Date of commencement of partnership is specified in this clause.
- vi. **Capital Contribution:** It mentions the amount of capital that each partner contributes whether capital accounts are fixed or fluctuating.
- vii. **Interest on Capital:** It specifies the interest on capital if such interest is allowed to be paid.
- viii. **Interest on Drawings:** It specifies the rate of interest on drawings if such interest is charged on drawings.

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- ix. **Profit-Sharing Ratio:** It specifies the ratio in which the profits and losses of the firm are shared by the partners.
- x. **Interest on Loan:** It specifies the rate of interest paid on the loan by the partner to the firm.
- xi. **Remuneration to Partners:** It specifies the amounts of salary, commission, etc. payable to the partners.
- xii. **Valuation of Goodwill:** It specifies the method by which the goodwill of the firm will be valued in the event of reconstitution of the partnership.
- xiii. **Valuation of Assets:** It specifies the manner in which assets of the firm shall be valued in the event of reconstitution of the partnership.
- xiv. **Settlement of Accounts:** It specifies the manner in which the accounts of the partner(s) shall be settled in case of partners' retirement or death or in the event of dissolution of the firm.
- xv. **Accounting Period:** It specifies the date on which accounts of the firm are closed every year.
- xvi. **Rights and Duties of Partners:** It specifies the rights and duties of the partners.
- xvii. **Duration of Partnership:** It specifies whether the partnership is for a specified period or for a venture or at will.
- xviii. **Bank Account Operation:** It specifies how the bank accounts should be operated; whether by any of the partners or jointly by all partners.
- xix. **Death of a Partner:** It specifies whether the firm will continue or dissolve in the event of death of a partner.
- xx. **Settlement of Disputes:** It specifies how the disputes among the partners shall be settled, if any arises.

Importance of Partnership Deed:

- i. An important legal document.
- ii. Defines relationship between the partners.
- iii. Governs the rights, duties and liabilities of each partner and therefore, avoids and settles possible disputes among the partners.
- iv. In case of any dispute among partners, partnership deed is considered as the basis for settlement of such dispute.
- v. Not essential but desirable to have a Partnership Deed
- vi. Where there is no partnership deed, provisions of Indian Partnership Act, 192 will be applied.

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

Provisions of the Indian Partnership Act, 1932 shall be applicable when there is no Partnership Deed or if the Partnership Deed is silent. Following are the matters for which provisions of this Act shall be applicable, if the partnership deed is silent on the same:

- i. **Sharing of Profits/Losses:** Profits/Losses are shared equally by the partners.
- ii. **Interest on Capital:** No such interest on capital is allowed to partners.
- iii. **Interest on Drawings:** No such interest on drawings is charged from partners.
- iv. **Interest on Advance/Loan by a Partner:** Interest shall be paid at the rate of 6%p.a. Such interest shall be payable even if there is a loss from business as it is a charge against profit.
- v. **Remuneration to Partners:** No partner shall be paid such remuneration as salary,

commission, etc. if the partnership deed is silent on such matter.

vi. **Liabilities of Partners:** Subject to agreement among the partners:

- a. **Profit from a similar business:** In case if a partner earns profit from a business that is similar to that of the firm in competition with the firm, then such profit earned from such business shall be paid to the firm.
- b. **Profit earned for self from firm's business:** In case if the partner earns profit for self from any business transaction of the firm or from the use of firm's property or business connection, the profit so earned shall be paid to the firm.

Limited Liability Partnership (LLP):

- **Meaning:** An LLP is a corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership.

The concept of Limited Liabilities partnership comes into existence with enactment of Limited Liabilities partnership act 2008

Main features of LLP: -

- (1) Name of LLP is approved is approved by the registrar of the company (ROC)
- (2) The LLP comes into existence by entering into agreement by the partners which are determined respective duties and responsibilities and also the profit - sharing ratio.
- (3) The agreement is filled with the registrar of the companies (ROC)
- (4) In this case the liabilities of the partner is limited to the extent of their capital
- (5) At least two persons should be appointed DESIGNATED persons one of whom must be a partner
- (6) LLP must file a SOLVENCY CERTIFICATE with the registrar of companies every year

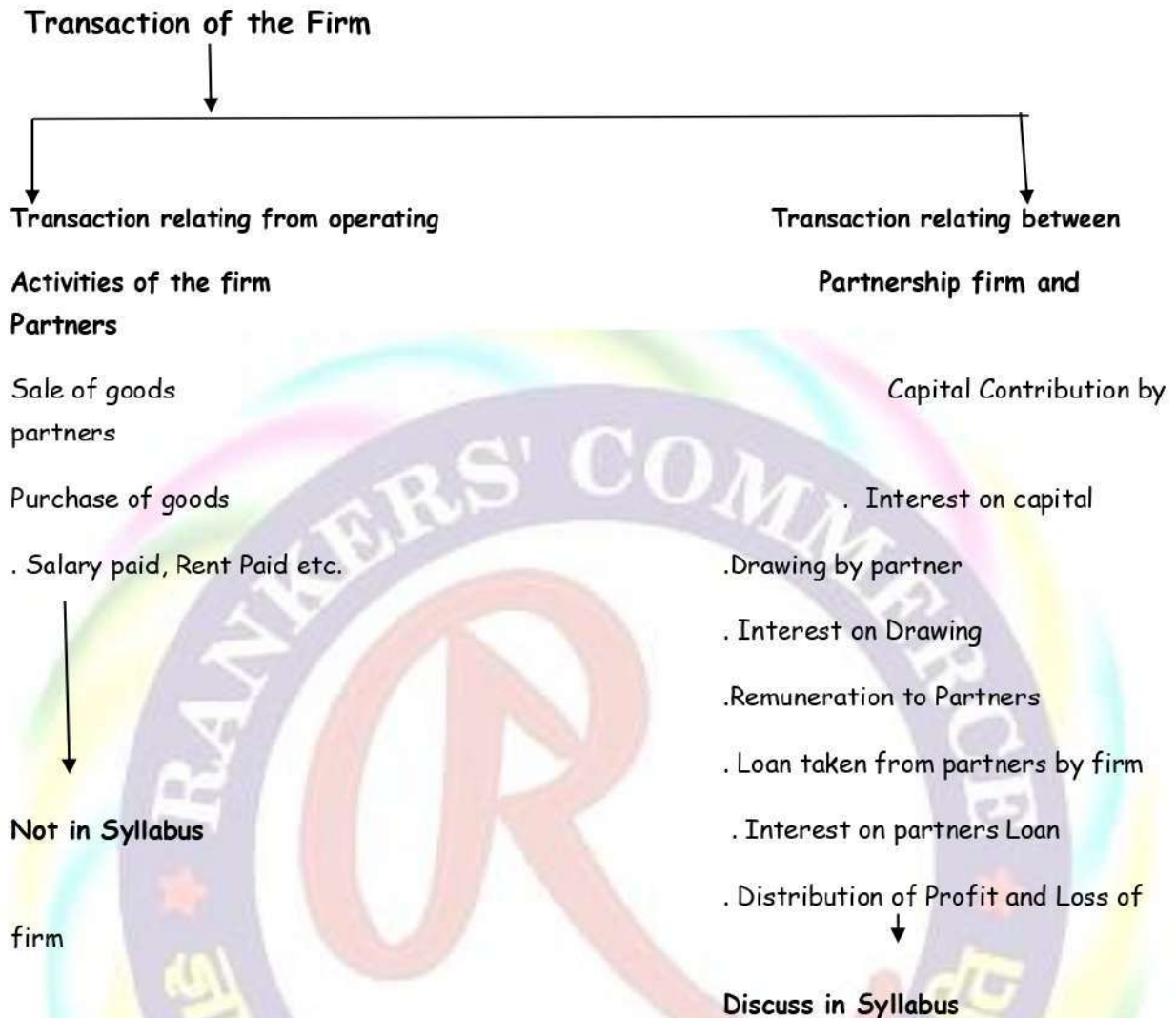
Accounting of partnership Firm

The entire system of partnership is based on the twin principles of mutual trust and faith. For these principles to exist and for the partnership to run smoothly and peacefully, it is essential that the books of accounts are maintained with transparency, honesty, integrity, accuracy and equity.

The double entry system of book -keeping is followed to maintain partnership accounts, as in case of proprietorship, except for the fact that capital accounts of the partners have to keep separately. Transaction of partnership firm is recorded according to principle of double entry system and as in the case of sole proprietorship concern.

The only difference between accounting of sole trading concern and that of partnership firm is that capital account of the partner has to be kept separately and the profit of the firm are divided among the partners for the purpose profit/ loss as per profit loss account is transferred into profit and loss appropriation account. In this case firm prepare **trading account, profit/loss account, profit and loss appropriation account, and balance sheet** at the end of every year.

For the purpose of the accounting treatment transaction of the firm are divided into two categories



The journal entries that are passed for various items Shown in the profit and loss appropriation account and partners' capital account are as follows:

1. When capital Contribution by partners

Cash/Bank A/c Dr
 To Partners capital A/c
 (Being capital contribution by partners)

2. When drawing by partners

Drawing (partners' capital a/c)Dr
 To Cash/Bank A/c
 (Being drawing by partners)

3. Entry for Interest on Capital

(1) On allowing interest on capital
 Interest on capital A/c Dr
 To partner's capital a/c / current a/c.
 (Interest on capital at -----% p.a.)

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(2) On closure of interest on capital A/c

Profit & loss appropriation A/c Dr
 To interest on capital A/c

4. Entry for Interest on Drawing

(1) On charging interest on drawings

Partner's capitals A/c / current a/c Dr
 To interest on drawings A/c

(Interest on drawings at-----% p.a.)

(2) On closure of interest on drawings A/c

Interest on drawings A/c Dr
 To profit & loss appropriation

a/c

5. Entry for Salary or Commission (remuneration) Payable to a Partner

(1) On allowing salary or commission to a partner

Partner's salary / commission A/c Dr
 To partner's capital A/c / current A/c

(2) On closure of salary or commission account

Profit & loss appropriation A/c Dr
 To partner's salary / commission

a/c

6. Entry for Transferring a Part of Profit to Reserve:

Profit & loss appropriation A/c Dr
 To reserve A/c

7. Entry for transfer of credit balance of profit & loss appropriation A/c (being profit)

Profit & loss appropriation A/c Dr
 To partner's capital or current A/c

9. Entry for Transfer of debit balance of profit & loss appropriation A/c (being loss)

Partner's capital or current a/c Dr
 To profit & loss appropriation A/c

Partners Capital Account

Partner's Capital Accounts: It is an account which represents the partner's interest in the business. In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partners may be maintained by any of the following two methods.

1. Fixed Capital Accounts

2. Fluctuating Capital Accounts

1. Fixed Capital Accounts

Under this method the original capitals invested by the partners remain constant, unless additional capital is introduced by an agreement. All entries relating to drawings, interest on capitals, interest on drawings, salary to partner, share of profits/losses are made in separate account which is called as Current Account. Thus the following two accounts are maintained

When capitals are fixed.

(i) Capital Account

This account will always show a credit balance: Balance of Capital account remains fixed, it does not change every year that is why it is called fixed capital method and only the following two transactions are recorded in the Fixed Capital Accounts:

Permanent Additional Capital Introduced

Permanent Capital Withdrawn or Drawings out of Capital only

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Partner's Capital A/C

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

(ii) Current Account

The Current account may show a debit or credit balance. All the usual adjustments such as interest on Capital, partner's salary/commission, drawings (out of profits), interest on drawings and share in profits or losses etc. are recorded in this account. All the Current Year's adjustments are recorded in this account that is why it is called Current account.

Partner's Current A/C

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

Note:

- Debit balance of Current Account is shown in Assets side of Balance Sheet.
- Credits balance of Current Account A/c is shown in Liabilities side of balance Sheet.
- Balance of Fixed Capital Accounts are always shown in Liabilities side of Balance Sheet as it will be always be credit balance.

2. Fluctuating Capital Accounts

In this method only one account i.e., Capital Account of each and every partner is prepared and all the adjustment such as interest on capital interest on drawings etc, are recorded in this account under this method, Capital account may show a debit or credit balance and the balance of this account changes frequently from time to time therefore it is called fluctuating Capital Account. In this method the capitals are not fixed. In the absence of information, the Capital Accounts should be prepared by this method.

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Partner's Capital

Particulars	X(Rs.)	Y(Rs.)	Particulars	X(Rs.)	Y(Rs.)
To Balance b/d	xxx	xxx	By Balance b/d	xxx	xxx
(Opening Dr. Balance)			(Opening Cr. Balance)		
To Cash/Bank A/c	xxx	xxx	By Cash/Bank A/c	xxx	xxx
(Capital Withdrawn)			(Additional Capital Introduced)		
To Drawings	xxx	xxx	By Interest on Capital	xxx	xxx
(out of profits)			By Partner's Salary or Commission	xxx	xxx
To Interest on Drawings	xxx	xxx	By Profit and Loss	xxx	xxx
To Profit and Loss A/c (share in loss) To Balance C/D (Closing)	xxx	xxx	By Appropriation A/c (share in profit) By balance C/D	xxx	xxx

Distinction between Fixed Capital Accounts and Fluctuating Capital Accounts

Fixed Capital Accounts	Fluctuating Capitals Accounts
<p>The balance in capital account usually remains unchanged except in extraordinary circumstances.</p> <p>Partners have two accounts capital accounts and current accounts</p> <p>All transactions relating to partner account are not made in capital account but are entered in separate current account. This cannot show a negative balance.</p>	<p>The Balance of Capital accounts change in time to time</p> <p>Partners have only capital account ;</p> <p>All transactions relating to partner account are made in their capital accounts.</p> <p>This can show a negative balance</p>

Profit/Loss Appropriation Account

Meaning of Profit and Loss Appropriation Account: Such Profit and Loss Appropriation Account is an extension of the Profit and Loss Account and therefore, the credit balance of the Profit and Loss Account is transferred to Profit and Loss Appropriation Account. Such amount is then utilized for the following:

- Interest on the capitals of partners, if provided by the partnership deed;
- Salaries or commissions to partners, if provided by the partnership deed;
- Transferring part of profit to Reserve;
- Distribution of profit among the partners in their profit sharing ratio

Difference between Profit and Loss Account and Profit and Loss Appropriation Account:

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	Basis	Profit and Loss Account	Profit and Loss Appropriation Account
1	Stage of Preparation	It is prepared after Trading Account and therefore, starts with Gross Profit or Gross Loss transferred from the Trading Account.	It is prepared after Profit and Loss Account and therefore, starts with Net Profit or Net Loss as transferred from the Profit and Loss Account.
2	Objective	It determines net profit earned or net loss incurred during the accounting Year.	It shows appropriation of net profit i.e., distribution of Net Profit for the accounting period among the Partners.
3	Nature of Items	It is debited with the expenses and credited with the income, not being business income to determine net Profit for accounting period.	It is debited with the items of appropriation of profit like salary, commission, interest on capital, transfer to reserve, etc. and credited with the items of income being debited to Partners' Capital Account or Current Accounts such as interest on drawings.
4	Partnership Deed	This account is not guided by the Partnership Deed or Agreement.	This account is prepared as guided by the Partnership Deed or Agreement or provisions of Indian Partnership Act, 1932.
5	Matching Principle	It follows the Matching Principle where Revenue is matched against expense.	It does not follow the Matching Principle.

Specimen of Profit and Loss Appropriation Account:

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Profit and Loss Appropriation Account

Dr.

for the year ended ...

Cr.

Particulars	Amount	Particulars	Amount
To Profit and Loss A/c (Net loss transferred from Profit and Loss Account)	...	By Profit and Loss A/c (Net Profit transferred from Profit and Loss Account)	
To Interest on Capitals:		By Interest on Drawings:	
A	...	A	...
B	...	B	...
To Partners' Salaries	—		—
To Partners' Commissions	...		
To Reserve	...		
To Profit transferred to:			
*A's Capital A/c	...		
*B's Capital A/c	...		
	—		

*In case of Fluctuating Capital Method, Profit will be transferred to Partners' Capital Accounts. In case of Fixed Capital Method, Profit will be transferred to Partners' Current Accounts.

INTEREST ON CAPITAL

Interest on partner's capital will be allowed only when it has been specifically mentioned in the partnership deed. If interest on capital is to be allowed as per the agreement, it should be calculated with respect to the time, rate of interest and the amount of capital.

Important point regarding interest on capital

- In order to compensate a partner for contributing capital to the firm in excess of the profit-sharing ratio, firm pays such interest on partner's capital.
- In case any amount is contributed by the partner to the firm in the form of additional capital during the year, interest on such additional capital is allowed for the period it has remained in business.
- In case if any amount of capital is withdrawn by the partner during the year, no interest is allowed on the capital amount withdrawn.

Important provisions relating to Interest on Capital:

If there is no Partnership Deed or there is no clause in the deed as to interest on capital: Interest on Capital is not allowed.

If the Partnership Deed provides for interest on capital but is silent as to the treatment of interest as a charge or appropriation: Interest on capital is treated as appropriation of profit. Such interest is payable only if the firm is making profits. Following are possible situations:

In case of loss: No interest is allowed.

In case of profit, where profit before interest is equal to or more than the interest: Interest is allowed at the agreed rate.

In case of profit, where profit before interest is less than the interest: Interest is allowed only to the extent of profit in the ratio of interest on capital of each partner.

If the Partnership Deed provides for interest as a charge in Profit (i.e., to be allowed whether there are profits or loss): Interest on capital is allowed whether there is profit or loss.

Other word Interest on Capital can be treated as either:

- a. An Appropriation of profit; or
- b. A charge against profit.

A. Interest on Capital: An Appropriation of Profits:

In case of Losses	Interest on Capital is NOT ALLOWED
In cases of Sufficient Profits	Interest on Capital is ALLOWED IN FULL
In case of Insufficient Profits	Interest will be restricted to the amount of profit. Hence, profit will be Distributed in the ratio of interest on capital of each partner.

B. Interest on Capital: As a Charge against Profits:

Interest on Capital is always allowed in full irrespective of amount of profits or losses.

Note: Interest on Capital is always calculated on the OPENING CAPITAL

Calculation of Interest on Additional Capital:

$$\text{Interest on capital} = \frac{\text{Additional capital introduced} \times \text{Rate}/100 \times \text{Time}}{\text{During the period} \quad 12/365/52}$$

Calculation of Interest on Opening Capital:

In case where the partner has not withdrawn capital or has not introduced additional capital during the year, closing balance of Capital Account of the previous year is the opening balance in the Capital Account.

Interest on Capital is allowed on the Opening Capital of the partner.

If the opening capital is not given, it can be determined by preparing Capital Accounts or with the help of following tables:

a. In case of Fixed Capital: Calculation of Opening Capital

Capital at the end of the year	...
Add: Withdrawal of Capital	...
Less: Additional Capital Introduced during the year	...
Capital in the beginning of the year	...

b. In case of Fluctuating Capital:

Calculation of Opening Capital

Capital at the end of the year	...
Add: Drawings Against Capital	...
Drawings Against Profit	...
Interest on Drawings	...
Share of Loss for the year*	...
Less: Additional Capital introduced during the year	...
Partner's Salary/Remuneration	...
Interest on Capital	...
Share of Profit for the year*	...
Capital in the beginning of the year	...

* Either loss or profit will appear at a time.

$$\text{Interest on capital} = \frac{\text{Amount of Opening capital} \times \text{Rate}}{100}$$

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Journal Entries for recording Interest on Capital:

a. Interest on Capital A/c ...Dr.

To Partners' Current A/c/Partners capital A/c

(Being the interest on capital allowed to partners)

b. Profit and Loss Appropriation A/c ...Dr.

To Interest on Capital A/c

(Being the interest on capital transferred to Profit and Loss Appropriation Account)

Alternatively: only one entry can be passed in place of above 2 entries as follows:

Profit and Loss Appropriation A/c ...Dr.

To Partners' Current A/c/Partners capital A/c

(Being the interest on capital allowed to partners)

INTEREST ON DRAWINGS

Interest on drawing is charged by the firm only when it is clearly mentioned in Partnership Deed. It is calculated with reference to the time period for which the money was withdrawn. There are two cases in which calculation of interest on drawings may arise:

When date of Drawings is given

$$\text{Interest on Drawing} = \frac{\text{Total Drawings} \times \text{Rate} \times \text{TIME}}{100 \times 12/365}$$

When date of Drawing is not given

$$\text{Interest on Drawing} = \frac{\text{Total Drawings} \times \text{Rate} \times 6}{100 \times 12}$$

Note: Interest is calculated for a period of 6 months, we assume drawings have been done evenly during the year that is why we take average six months tenure.

When different amount are withdrawn on different dates:

We have the following two methods to calculate the amount of interest on Drawing:

1. Simple Interest Method

In this method, interest on drawing is calculated for each amount of drawing individually on the basis of periods for which it remained withdrawn till the close of accounting period.

2. Product Method

In this method, the amounts of drawings are multiplied by the period for which it remained withdrawn during the period; thereafter the products are added and interest is calculated on the total of products so arrived at for one month. The advantage of this system is that separate calculations are not required each time.

We can explain the above mentioned two methods with the help of an example.

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Month	Date	Drawings Amount
May	1	12000
July	31	6000
September	30	9000
November	30	12000
January	1	8000
March	31	7000

Interest on drawings is to be charged @ 9% p.a
SIMPLE METHOD

DATE	AMOUNT	PERIOD	INTEREST @9%
1 MAY	12000	11	990
31 JULY	6000	8	360
30 SEP	9000	6	405
30 NOV	12000	4	360
1 JAN	8000	3	180
31 MAR	7000	0	00
Total	54000		2295

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PRODUCT METHOD

DATE	AMOUNT	PERIOD	PRODUCTS
	(A)	(B)	P=A*B
1 MAY	12000	11	132000
31 JULY	6000	8	48000
30 SEP	9000	6	54000
30 NOV	12000	4	48000
1 JAN	8000	3	24000
31 MAR	7000	0	00
TOTAL	54000		306000

$$\text{Interest} = \frac{\text{Total of product} \times \text{Rate} \times 1}{100 \times 12/365}$$

$$\text{Interest} = \text{Total of products} \times 9/100 \times 1/12 = 306000 \times 9/100 \times 1/12 = \text{Rs } 2295/-.$$

Average Method: (Different situations)

Case (1) When Drawings is made in the beginning of every month: If the drawings of equal amount

$$\text{Average period} = \frac{\text{Time left after first drawings} + \text{Time left after last drawings}}{2}$$

$$= \frac{12 \text{ Months} + 1 \text{ Month}}{2} = 6\frac{1}{2} \text{ Months}$$

Case (2) When Drawings are made at the end of every month:

$$\text{Average period} = \frac{\text{Time left after first drawings} + \text{Time left after last drawings}}{2}$$

$$= \frac{11 \text{ Months} + 0 \text{ Month}}{2} = 5\frac{1}{2} \text{ Months}$$

Case (3) when Drawings are made in middle or at any time during the month: (middle)

$$\text{Average period} = \frac{\text{Time left after first drawings} + \text{time left after last drawings}}{2}$$

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$$\frac{= 11.5 \text{ Months} + 0.5 \text{ Month}}{2} = 6 \text{ Months}$$

Case (4) when drawings of equal amount are made in the beginning of each quarter:

Average period = Time left after first drawings + Time left after last drawings

$$\frac{= 12 \text{ Month} + 3 \text{ month}}{2} = 7\frac{1}{2} \text{ Months}$$

Case (5) when drawings of equal amount are made at the end of each quarter:

Average period = Time left after first drawings + Time left after last drawings

$$\frac{= 9 \text{ Months} + 0 \text{ Month}}{2} = 4\frac{1}{2} \text{ Months}$$

Case (6) when drawings of equal amount are made during the middle of each quarter:

Average period = Time left after first drawings + Time left after last drawings

$$\frac{= 10.5 \text{ Months} + 1.5 \text{ Months}}{2} = 6 \text{ Months}$$

Case (7) when drawings of equal amount are made only during a period of 6 Months:

(i) In the beginning of each month:

$$\frac{\text{Average period} = 6 \text{ Months} + 1 \text{ Month}}{2} = 3\frac{1}{2} \text{ Months}$$

(ii) At the end of each month:

$$\frac{\text{Average period} = 5 \text{ Months} + 0 \text{ Month}}{2} = 2\frac{1}{2} \text{ Months}$$

(iii) In the middle of each month:

$$\frac{\text{Average period} = 5\frac{1}{2} \text{ Months} + \frac{1}{2} \text{ Month}}{2} = 3 \text{ Months}$$

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Case (8) when drawings of equal amount are made during 9 months.

(i) In the beginning of each month

Average period = $\frac{\text{Time left after first drawings} + \text{Time left after last drawings}}{2}$

$$\begin{aligned} &= \frac{9 \text{ Months} + 1 \text{ Month}}{2} = 5 \text{ Months} \end{aligned}$$

(ii) At the end of each month

Average period = $\frac{\text{Time left after first drawings} + \text{Time left after last drawings}}{2}$

$$\begin{aligned} &= \frac{8 \text{ Months} + 0 \text{ Month}}{2} = 4 \text{ Months} \end{aligned}$$

(iii) In the middle of each month

Average period = $\frac{\text{Time left after first drawings} + \text{Time left after last drawings}}{2}$

$$\begin{aligned} &= \frac{8.5 \text{ Months} + 0.5 \text{ Month}}{2} = 4.5 \text{ Months} \end{aligned}$$

Case (9) when the rate of interest is given without the word 'per annum' interest will be charged without considering time or date of drawings.

1. Interest on Drawings is charged @ 10% per annum

$$\frac{\text{Amount on Drawings} \times \text{Rate of Interest} \times 6}{100 \times 12}$$

2. Interest on Drawings is charged @ 10%

$$\frac{\text{Amount on Drawings} \times \text{Rate of Interest}}{100}$$

Interest on Partner's Loan

If a partner has given loan to the firm, he is entitled to receive interest on such loan at an agreed rate. It is a charge against profits. It is provided irrespective of profits or loss. The rate of interest on partners' loan is specified in the Partnership Deed. It will also be provided in the absence of Partnership Deed @ 6% per annum.

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Accounting Treatment: Journal Entries passed are as follows:

1. When provide Interest on Partners' Loan:

Interest on Partner's Loan A/c ...Dr.

To Partners' Loan A/c

2. When close the Interest on Partners' Loan A/c:

Profit and Loss A/cDr

To interest on partners loan A/c

It is always DEBITED to Profit and Loss A/c

Rent Paid to Partner.

Rent paid to a partner is also a charge against profits and it will also be

DEBITED to Profit and Loss A/c

Note:

$$\begin{aligned} \text{Interest on A's Loan} &= \frac{\text{Loan Amount} \times \text{Rate} \times \text{Time left after loan taken}}{100} \\ &= \frac{200000 \times 6 \times 05}{100 \times 12} = \text{Rs. } 5,000 \end{aligned}$$

Salary or Commission (Remuneration) to Partners:

- In order to compensate the partners for looking after the business, the firm pays salary or commission to the partners.
- Such salary or commission can be allowed to the partners only if the Partnership Deed allows it to be paid.
- Such amount paid to the partners is an appropriation of profit and not a charge against the profit. Therefore, it can be paid only if the firm is making profits during the year.
- Salary to partners is normally stated as an amount, whereas, Commission to partners is normally stated as a percentage of profit where the profit considered can be either before commission or after commission.

Formula for computing commission under the 2 methods is as follows

(1) On profits before charging such commission

Profit (before commission) X Rate of Commission

100

(2) On profits after charging such commission

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

Accounting treatment: Salary or Commission, is an appropriation of profit, therefore, accounting treatment will be as follows:

a. On allowing Salaries/Commissions to Partners:

Partners salaries/commissions A/cDr
To Partners capital/Current A/c

b. On closure of Salaries/Commissions A/c

Profit and Loss Appropriation A/cDr.
To Partners' Salaries/ Commissions A/c

GUARANTEE OF PROFITS TO A PARTNER

Guarantee is an assurance given to the partner of the firm that at least a fixed amount shall be given to him/her irrespective of his/her actual share in profits of the firm. If actual share in profits is less than the guaranteed amount in that case the deficit amount shall be borne either by the firm or by any partner as the case may be or as may have been decided by an agreement.

Note:

Guarantee to a partner is given for minimum share in profits. If the actual share in profits is more than the minimum share in profits, then the actual profits will be allowed to the partner.

Case: 1. when guarantee is given by FIRM (i.e. by all the Partners of the firm)

If share in actual profits is less than the guaranteed amount then. Guaranteed amount to a partner is first written off against the profits and then,

Remaining profits are distributed among the remaining partners in the remaining ratio.

Case2. When guarantee is given by a partner or partners to another partner.

Calculate the share in profits for the partner to whom guarantee is given.

If share in profits is more than the guaranteed amount, distribute the profit as per the profit and loss sharing ratio in usual manner.

If share in profits is less than the guaranteed amount, find the difference between the share in profits and the guaranteed amount and the difference known as deficiency.

Deficiency is contributed by the partner or partners who guaranteed in certain ratio and subtracted from his or their respective shares.