

Chapter-2

Accounting for partnership-Basic concept

Partnership is a form business which is owned by two or more persons who have agreed to share the profits /Loss of a business carried on by all or any one of them acting for all.



UNLIMITED LIABILITY

- **Unlimited liability** means that each partner is personally and individually liable for all partnership liabilities.

's Only Business

Features of Partnership

1. Number of members

Minimum-2



Maximum-100



Features of Partnership

2. Agreement

To form a partnership there must be an agreement. It may be oral or written ,written agreement is known as PARTNERSHIP DEED



Features of Partnership

3. Always to conduct a Business

The partnership should be to carry on some lawful business.

LEGAL
BUSINESS



Features of Partnership

4. Unlimited Liability



UNLIMITED LIABILITY =
debt



Features of partnership

5.No Separate Legal Existence

It has no separate legal existence apart from its members. It can't purchase property on its own name.



Features of Partnership

6. Sharing of Profit/Loss

The profit should be shared by the partners in an agreed ratio.



Partnership Deed

The agreement in writing, containing the terms and conditions of partnership as agreed between partners is called 'partnership deed'.

Contents of Partnership Deed

1. Name of the firm.
2. Names and addresses of all partners.
3. Nature and places of business.
4. Date of commencement of partnership.

Contents of Partnership Deed

5. Duration of partnership, if any.
6. Rules regarding operation of bank accounts.
7. Amount of capital contributed by each partner.
8. Profit sharing ratio between partners, if any.
9. Interest on partners loan to the firm, if any.
10. Interest on partner's capital and drawings, if any.

Contents of Partnership Deed

11. Salary, commission, if any, payable to a partner.

12. Rights, duties and liabilities of partners.

12. Method of computation and treatment of goodwill on reconstitution of a firm.

13. Mode of settlement of accounts at the time of admission, retirement, death and dissolution of firms.

Rules applicable in the absence of Partnership Deed or if the deed is silent on any matter

1. Profit Sharing

Partners are entitled to share profit and losses **equally**



Rules applicable in the absence of Partnership Deed or if the deed is silent on any matter

2. Interest on Capital

No Interest on capital is payable to partners



Rules applicable in the absence of Partnership Deed or if the deed is silent on any matter

3. Interest on Drawings

No interest will be charged on drawings made by partners.



Rules applicable in the absence of Partnership Deed or if the deed is silent on any matter

4. Remunerations like salary, commission etc.

No one is entitled to get salary or commission.



Rules applicable in the absence of Partnership Deed or if the deed is silent on any matter

5. Interest on Partners Loan to the Firm

Partners are entitled to get interest @ 6% p.a. on loans advanced by the partners. It should be paid even if there is loss



Appropriation of Profit and Charge Against Profit

Appropriation of Profit

P & L Appropriation A/C

It is the distribution of net profit to various heads. It is made only if there is a profit.

Example: Interest on capital, salary to partner, commission to partners, amount transferred to reserve etc.

Charge Against Profit

P & L Account

It is the deduction from revenue to ascertain net profit or net loss. It is made even if there is loss. It will be debited to profit and loss account. Interest on loan, depreciation, salary to staff, bad debts etc.

Important Accounts in Partnership

- Partners Capital account
- Partners Current Account
- Profit and Loss Appropriation Account
- Drawings Account

Partner's Capital Account

All transactions relating to the partners of a firm are recorded in their capital accounts. This includes the amount of money brought in as capital, withdrawal of capital, share of profit, interest on capital, Drawings, interest on drawings, partner's salary, commission, etc. Partners capital account is a personal account. Partners capital account can be maintained in two ways:-

1. Fluctuating Capital Method
2. Fixed Capital Method



Partner's Capital Account

1. Fluctuating Capital Method

Under fluctuating capital method, there is only one account, viz. capital account for each partner is maintained. All transactions relating to partners of a firm are recorded in their capital accounts.

Features:-

- In this method only one account, i.e., partners capital A/C
- All adjustment like interest on capital, partner's salary, drawings, interest on drawings etc. are recorded in capital account itself.
- Balance of partner's capital account will fluctuate from year after year.

1.Fluctuating Capital Method

Partner's Capital A/C (Fluctuating Method)

Particulars	Amount	Particulars	Amount
To Balance b/d (If Debit balance)	xxxxx	By Balance b/d (If Credit balance)	xxxxx
To Drawings	xxxxx	By Cash (If additional capital introduced)	xxxxx
To interest on drawings	xxxxx	By Salary	xxxxx
To Profit and Loss Appropriation A/C (Share of loss)	xxxxx	By Commission	xxxxx
To Balance c/d (If Credit Balance)	xxxxx	By Interest on Capital	xxxxx
		By Profit and Loss Appropriation(Share of Profit)	xxxxx
	<u>xxxxxxx</u>		<u>xxxxxxx</u>

Fixed Capital Method

Under fixed capital method two accounts are maintained for each partner, viz. Partner's Capital Account and Partner's Current Account. Opening capital balance and additional capital introduced, capital withdrawal (if any) are recorded in capital account. All other adjustments like interest on capital, salary, drawings, interest on drawings etc. are recorded in a separate account known as partners current account.

Features:-

- Two accounts are maintained for each partner.
- All adjustments are recorded in Partner's Current Account.
- Capital Account balance will remain unaltered unless additional capital introduced or withdrawn.

FIXED CAPITAL METHOD

Partners' Capital Account					
Particulars	A	B	Particulars	A	B
To drawings	XXX	XXX	By balance b/d	XXX	XXX
(permanent withdrawal)	XXX	XXX	By Cash/Bank (additional capital)	XXX	XXX
To balance c/d					

Two Accounts

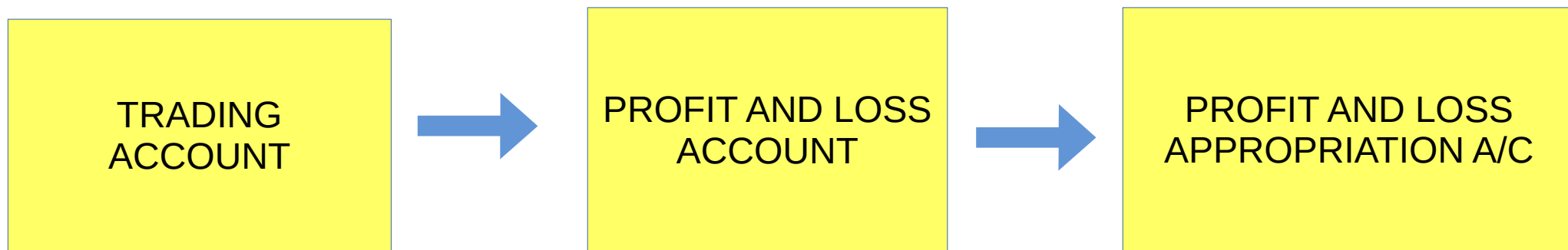
Partners' Current Account					
Particulars	A	B	Particulars	A	B
To balance b/d	XXX	XXX	By balance b/d	XXX	XXX
To drawings	XXX	XXX	By interest on capital	XXX	XXX
To Interest on drawings	XXX	XXX	By salary	XXX	XXX
To profit & Loss Appropriation A/c (In case of Loss)	XXX	XXX	By commission	XXX	XXX
To balance c/d	XXX	XXX	By profit & Loss Appropriation A/c (In case of Profit)	XXX	XXX
	XXX	XXX	By balance c/d	XXX	XXX

Difference Between Fixed Capital Method And Fluctuating Capital Method

Fixed Capital Method	Fluctuating Capital Method
Two Accounts	One Account
All Adjustments Recorded in Current A/C	All Adjustments Recorded in Capital A/C Itself
Normally No changes in Capital Account Balance	Capital Account Balance Will Change
Both Capital and Current Account Balance in Balance Sheet	Only Capital Account Balance in Balance Sheet
Capital Account Always Show Credit Balance	Capital Account may Show Debit or Credit Balance

Profit and Loss Appropriation Account

In Partnership distribution of profit or loss among partners through a separate account known as Profit and Loss appropriation account. It is an extension of profit and loss account. It is opened with net profit/ net loss brought forward from profit and Loss Account.



Profit and Loss Appropriation A/C

In partnership there is an agreement between partners with regard to salary to partners, commission, interest on capital and interest on drawings etc. So Net Profit reflected in profit and loss account required some adjustments with regard salary to partner, commission, interest on capital etc. before its distribution among partners. These adjustments takes place in a separate account called Profit and loss appropriation account.

P&L A/C

Net profit-Closing
Balance of profit
And loss a/c

P&L APPROPRIATION A/C

Net profit is brought forward(as opening Balance) to P&L Appropriation a/c, here some adjustment is required for net profit.

CAPITAL A/C

Divisible Profit/Loss
Is the end result of P&L Appropriation A/C. It should be transferred to partners Capital A/C in their profit sharing ratio

Profit and Loss Appropriation A/C

It is credited with interest on drawings. It is debited with salary to partner, commission to partner, amount transferred to reserve (if any) etc. At the end this account should be balanced and if it show credit balance, it means profit and should be transferred to the credit side of partners capital account in their profit sharing ratio and vice versa.

Profit and Loss Appropriation A/c

Particulars	Amount	Particulars	Amount
By P&L Account(Net loss)	xxxx	By P&L Account(Net Profit)	xxxx
By Salary	xxxx	By Interest on Drawings	xxxx
By Commission	xxxx		
By Interest on Capital	xxxx		
By Reserve(if any)	xxxx		
By Partners capital(B/F) (in their ratio)	xxxx		
	<u>xxxx</u>		<u>xxxx</u>

Profit and Loss appropriation Account

Features:-

- It is a nominal account.
- It is an extension of profit and loss account.
- It is prepared to show how the net profit has been distributed among partners.
- It is opened with net profit or loss.
- It is credited with interest on drawings.
- It is debited with salary to partner, commission to partner, interest on capital etc.
- If it show credit balance ,it means distributable profit and should be credited to partners capital account in their profit sharing ratio.

Profit and Loss Appropriation Account

Journal Entries:-

Particulars	Debit	Credit
<u>For transfer of Net Profit:</u> P & L Account Dr To P & L Appropriation Account (Net profit Transferred to P & L Appropriation A/C)	XXXX	XXXX
<u>For Transfer of net loss(if any)</u> P & L Appropriation Account To P & L Account (Net Loss Transferred to P & L Appropriation A/C)	XXXX	XXXX
<u>For Allowing Interest on Capital</u> Interest on Capital A/C Dr To Partners Capital A/C (Interest on Capital allowed)	XXXX	XXXX

<u>For Closing Interest on Capital Account</u> P & L Appropriation A/C Dr To Interest on Capital A/C (Interest on capital account is closed by transferred it to P & L Appropriation A/C)	XXXX	XXXX
<u>When Salary Due</u> Partners Salary A/C Dr To Partner's Capital A/C (Salary due)	XXXX	XXXX
<u>For Closing Salary Account</u> P & L appropriation A/C Dr To Partner's Salary A/C (Salary account closed by transferred it to P & L Appropriation A/C)	XXXX	XXXX
<u>For Transfer to Reserve</u> P & L appropriation A/C Dr To Reserve A/C (Amount transferred to reserve)	XXXX	XXXX

<u>For Charging interest on drawings</u> Partner's Capital A/C Dr To Interest on Drawings Interest on drawings charged to partners capital A/C	XXXXXX	XXXXXX
<u>For closing Interest on Drawings</u> Interest on Drawings A/C Dr To P & L Appropriation A/C (Interest on drawings account closed by transferred to P & L Appropriation A/C)	XXXXXX	XXXXXX
<u>For transfer of balance in the P& L Appropriation A/C (If Profit)</u> P & L Appropriation A/C Dr To Partner's Capital A/C (Divisible profit distributed among partners in their ratio)	XXXXXX	XXXXXX
<u>For transfer of balance in the P& L Appropriation A/C (If Loss)</u> Partner's Capital A/C To P & L Appropriation A/C Dr (Divisible profit distributed among partners in their ratio)	XXXXXX	XXXXXX

Profit and Loss appropriation Account

Profit and Loss Appropriation A/C			
Particulars	Amount	Particulars	Amount
Net Loss b/d (If any)	xxxx	Net Profit b/d (If any)	xxxx
Salary	xxxx	Interest on Drawings	xxxx
Commission	xxxx		
Reserve	xxxx		
Partners Capital A/C (In their ratio)	xxxx		
	xxxxxx		xxxxxx

Profit and Loss appropriation Account

Items to be credited:-

- Net Loss b/d (P&L A/C)
- Interest on capital
- Salary to partner
- Commission to partner
- Amount transferred to reserve

P & L Appropriation A/C

Profit and Loss appropriation Account

Items to be debited:-

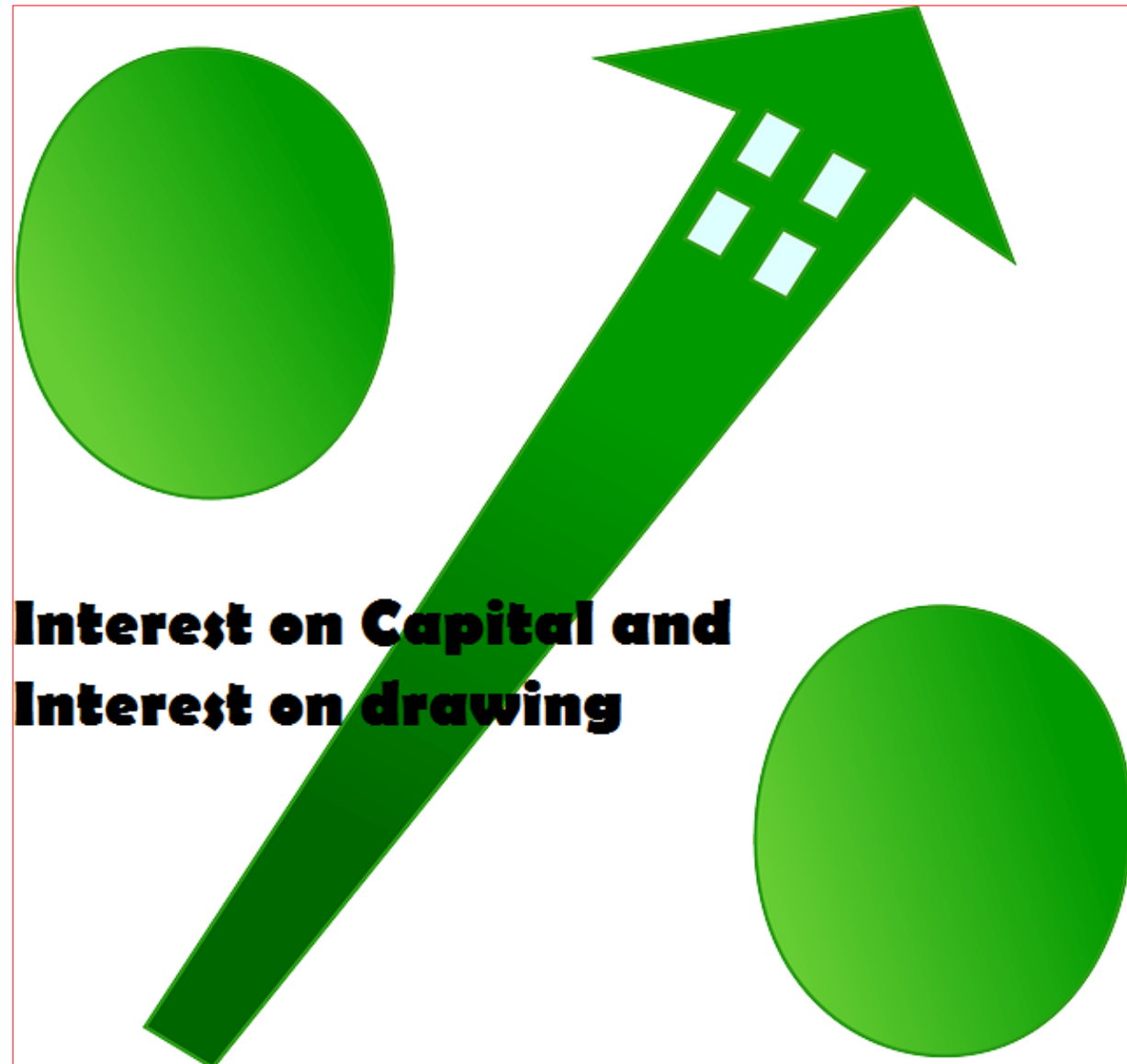
- Net Profit b/d (P&L A/C)
- Interest on Drawings

P & L Appropriation A/C

Some Important Calculations:-

1. Interest on Drawings

2. Interest on Capital



Interest on Capital

The interest on capital is paid to the partners as a compensation for their capital contribution to the firm. Interest on capital is an expense to the firm and a gain to partners individually. No interest is allowed on partners' capital unless it is agreed between partners.

Gain to Partners



Interest on Capital

Interest is generally calculated on the opening capital and credited to partners capital account. It is an appropriation of profit and it should be noted that interest on capital is payable only out of profit. No interest on capital if there is loss.

Interest on capital = Capital of the partner $\times$ Rate $\times$ period for which amount remained in the business.

Gain to Partners



Interest on Capital -No Addition or Withdrawal

Interest on capital=Opening capital x rate x period
for which amount remain in business.

Q.Amal and Bimal entered into partnership business on 01-01-2017 by bringing in Rs.300000 and Rs.200000 respectively. They decided to share profit and losses equally and agreed that the interest on capital will be provided to the partners @ 10% per annum. There was no addition or withdrawal of capital by any partner during the year. Calculate interest on capital of Amal for the year?

opening Capital only

$$\begin{aligned}\text{Interest on capital of Amal} &= 300000 \times 10/100 \times 12/12 \\ &\text{OR} \\ &= 300000 \times 10\% \\ &= \mathbf{30000}\end{aligned}$$

Interest on Capital – When Additional capital introduced during the accounting year.

Opening + Additional

1. On opening capital interest for full year
2. On the additional capital interest from the date of contribution to the end of the period

Anna and Maria are partners in a firm. Anna's capital account showed a balance of Rs.50,000 on 01-01-2017. During the year 2017 Anna introduced an additional capital of Rs.10,000 on 1st August 2017. The Interest on capital allowed @ 8% p.a. Accounts are closed on December 31st every year. Calculate interest on capital to be allowed to Anna during the year 2017.?

For Anna's opening capital for full year, i.e. $50,000 \times 8\% = 4,000$

For Anna's additional capital from the date of contribution (1-8-2017) to the end of the period (31-12-2017), i.e. $10,000 \times 8\% \times 5/12 = 333$

Total Interest on capital of Anna = $4000 + 333$
= 4333

Interest on Capital – When there is withdrawal out of capital during the year

In this case interest is calculated as follows:-

1. On opening capital interest is calculated for full year (1)
2. On the amount of capital withdrawn during the year interest for the period from the date of withdrawal to the closing day and deduct it from the above (1)

Opening + Withdrawal

Interest on Capital – When there is withdrawal out of capital during the year

Q. Sneha and Varsha are partners in a firm. Their capital accounts as on 1-04-2017 showed a balance of Rs.2,00,000 and Rs.3,00,000 respectively. On October 1st 2017 Sneha withdraw Rs.30,000 from her capital. Interest is allowed @8% p.a. Calculate interest on capital of Sneha for the financial year 2017-2018?

On opening capital for full year, i.e. $2,00,000 \times 8\% = 16,000$ (1)
Calculate interest on the amount of capital withdraw for the period from the the date of withdraw to the closing date,
i.e. $3,000 \times 8\% \times 6/12 = 1200$ (2)
Interest on capital(1-2) = $16000 - 1200$
= **14,800**

Interest on Capital – When there is both addition and withdrawal of capital by partners during the year

1. On opening capital interest is calculated for full year (1)
Opening + Addition + Withdrawal
2. On additional capital from the date of contribution to the end of the period (2)
3. On the amount of capital withdrawn during the year interest for the period from the date of withdrawal to the closing day and deducted from the total of the interest calculated under point(1) and point (2).

Interest on Capital – When there is both addition and withdrawal of capital by partners during the year

Tomy and George are partners in a firm. Their capital account balance as on 1-4-2017 showed a balance of Rs.5,00,000 and Rs.2,00,000 respectively. On June 1st, Tomy introduced additional capital of Rs.20,000. On November 1st, Tomy withdrew Rs.30,000 from his capital. Interest on capital is allowed @10% p.a. Calculate interest on capital

Ans.

On opening capital (5,00,000) Interest on capital for whole year

$$\text{i.e., } 5,00,000 \times 10\% = 50,000 \text{ (1)}$$

On additional capital from the date of contribution (1-6-2017) to the closing date (31-3-2018)

$$\text{i.e., } 20,000 \times 10\% \times 10/12 = 1,667 \text{ (2)}$$

On the amount of capital withdrawn for the period from the date of withdrawal (1-11-2017) to the closing day (31-3-2018)

$$\text{i.e., } 30,000 \times 10\% \times 5/12 = 1,250 \text{ (3)}$$

Net interest on capital = (1) + (2) – (3)

$$\text{i.e., } 50,000 + 1,667 - 1,250 = 50,417$$

Calculation of opening capital when only closing capital is given

Closing Capital		XXXXXX
Add:		
Drawings	XXXXXX	
Interest on Drawings	XXXXXX	
Share of Loss(if any)	XXXXXX	XXXXXX
	-----	-----
		XXXXXX
Less:		
Partners Salary	XXXXXX	
Partners Commission	XXXXXX	
Share of Profit	XXXXXX	XXXXXXX
	-----	-----
Opening Capital		<u>XXXXXXX</u>

INTEREST ON DRAWINGS

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Interest on Drawings

It is the amount charged by the firm on drawings made by partners. No interest is charged on drawings if there is no agreement between partners in this regard. However, if the partnership deed so provides interest is charged at an agreed rate, for the period the money is outstanding during the accounting year. It is an expense to the partner and income to the firm.

Expense to Us



Interest on Drawings

Calculation of interest on drawings under different situation:-

Case1: Amount of withdrawal, rate of interest and date of withdrawal are given

Interest on drawings=amount of drawings x rate x period

Q.Johnson ,a partner withdraws Rs. 16,000 on 1st May 2017.Books of accounts are closed on 31st December every year. Calculate interest on drawings at 6% per annum.

Ans.

Interest on drawings=amount of drawings x rate x period

$$=16,000 \times 6\% \times 8/12$$

$$=640$$

Interest on Drawings

Case: 2 Date of withdrawal is not given, amount and rate of interest is given

If the date of drawings is not given, it may be assumed that drawings were made evenly throughout the year. In such a case interest should be calculated for six months on the whole amount.

Interest on drawings = amount of drawings $\times$ rate $\times$ 6/12

Q. Sachin, a partner withdraws Rs. 8,000 in a year and interest is chargeable on the drawings at 7% per annum. Calculate interest on drawings.

Ans.

Here date of drawings is not given. So interest should be calculated for six months on the whole amount.

$$\begin{aligned}\text{Interest on drawings} &= 8,000 \times 7\% \times 6/12 \\ &= \mathbf{280}\end{aligned}$$

Interest on Drawings

Case:3 Different amounts withdrawn at different intervals

In case date of drawings and the different amounts withdrawn are clearly stated, the interest on drawings can be calculated with the help of the **product method**

Steps in product method:-

Step-1 Calculate the time **period** between date of withdrawal and closing date

Step-2 Multiply the time period so calculated by the respective amount of drawings. This is called the **Product**.

Step-3 **Add** up the various products

Step-4 Calculate interest for **one month** on the sum of products at the rate of percentage.

Interest on Drawings-Product Method

Johnson a partner in a firm, withdrew the following amounts during the year 2017.

March-1	6000	The interest on drawings is to be charged 12% p.a. Assuming accounting year closes on Dec 31. Calculate interest on drawings chargeable to the partner?
June-1	4000	
August-1	5000	
November-30	2000	

Calculation of Interest on Drawings by Product Method

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

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

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

Interest on Drawings-Fixed Amount withdrawn Every Month

If a partner withdraws fixed amount at regular intervals, the interest on drawings can be calculated on the basis of average period.

Interest on Drawings

= Total Drawings x Rate/100 x Average Period

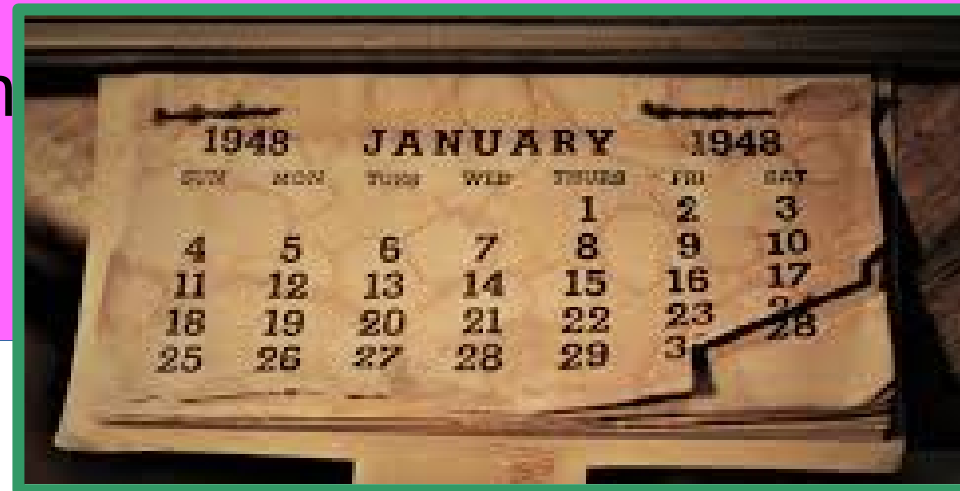
The calculation of average period depends upon whether the fixed amount is withdrawn on the first day of each month, middle of the month or at the end of each month

Date of Withdrawal	Average Period
First day of every month	6.5 Months
Middle of every month	6 Months
End of every month	5.5 months

Interest on Drawings-Fixed Amount withdrawn Every Month

Q. Manoj, a partner withdraws a sum of Rs. 2,000 per month from the firm. Interest on drawings is to be charged @ 8% per annum. What is the interest that should be charged to partner if drawings are made:-

- (1) In the beginning of each month
- (2) In the middle of each month
- (3) In the end of each month



Ans.

Interest on Drawings

= Total Drawings x Rate/100 x Average Period

Total drawings = 2000 x 12
= 24,000

Interest on Drawings-Fixed amount withdrawn every Month

Interest on Drawings

$$= \text{Total Drawings} \times \text{Rate}/100 \times \text{Average Period}$$

Ans-1-First Day of the month

$$\begin{aligned} \text{Interest on Drawings} &= 24000 \times 8/100 \times 6.5/12 \\ &= 1040 \end{aligned}$$

Ans-2-Middle of the month

$$\begin{aligned} \text{Interest on Drawings} &= 24000 \times 8/100 \times 6/12 \\ &= 960 \end{aligned}$$

Ans-3-End of the month

$$\begin{aligned} \text{Interest on Drawings} &= 24000 \times 8/100 \times 5.5/12 \\ &= 880 \end{aligned}$$

Interest on Drawings -Fixed Amount withdrawn in Every Quarter

Date of Withdrawal	Average Period
First day of every quarter	7.5 Months
Middle of every quarter	6 Months
End of each quarter	4.5 Months

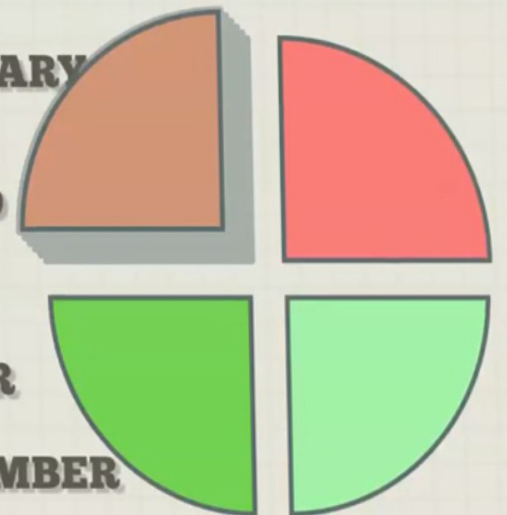


**Q1: JANUARY, FEBRUARY
AND MARCH**

**Q2: APRIL, MAY AND
JUNE**

**Q3: JULY, AUGUST
AND SEPTEMBER**

**Q4: OCTOBER, NOVEMBER
AND DECEMBER**



Journal Entry- interest on Drawings

Interest on drawing is an income for the firm and expense to each partner

Journal Entry-*When interest on drawings charged among partners*

Partner's Capital AC	Dr	xxxx	
	To Interest on Drawings		xxxx
(Interest on drawings charged among partner's capital account)			

Journal Entry-*To close interest on drawings account*

Interest on Drawings A/C	Dr	xxxx	
	To Profit and Loss Appropriation A/C		xxxx
(Interest on drawings account closed by transfer it to P & L Appropriation A/C)			

Guarantee of Profit to a Partner



Guarantee of Profit to a Partner

Sometimes, on admission of a new partner, old partners may give an assurance to the new partner that, he shall be given a minimum amount of profit irrespective of the actual profit. This guaranteed profit is to be paid only if the new partner's share of profit as per the ratio is less than the guaranteed amount.



Guarantee of Profit to a Partner

Mohan and Krishnan are partners in a firm. They admit Sunny as a partner with a guarantee that his share of profits shall not be less than Rs.20,000. Profit are to be shared in the proportion of 4:3:3. The total profit for the year 2017 were Rs.50,000. Prepare P&L Appropriation A/C showing the division of profit of the year 2017.

Here, Guaranteed partner is Sunny

Sunny's guaranteed profit = 20,000.

Profit sharing ratio between Mohan, Krishnan and Sunny = 4:3:3

Firm's profit = 50,000

Sunny's actual profit is $50,000 \times \frac{3}{10} = \text{Rs.}15,000$

i.e. Sunny's actual profit (15,000) is less than his guaranteed sum (20,000). The deficiency amount Rs.5,000 should be given to Sunny by Mohan and Krishnan in their profit sharing ratio (4:3)

Guarantee of Profit to a Partner

Profit and Loss appropriation account

Particulars		Amount	Particulars		Amount
Mohans Capital	20,000	17,143	Net Profit (P & L Account)	50,000	
Less :Share of deficiency	<u>2857</u>				
Krishnan's Capital	15,000				
Less :Share of deficiency	<u>2143</u>	12,857			
Sunny,s Capital	15,000				
Add: Deficiency	<u>5000</u>	20,000			
(2857 + 2143)					
		<u>50,000</u>		<u>50,000</u>	

We Guarantee



PAST ADJUSTMENTS



mistakes



CORRECTION

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Past Adjustments

In certain cases, after the preparation of final accounts and partners capital account, it is found that certain items are to be omitted or wrongly treated. Such errors and omissions usually relate to interest on capital, interest on drawings, wrong distribution of profit, interest on partners loan, salaries to partners etc. All such errors or omission to be adjusted to correct their impact in the capital balances of partners. Instead of altering old accounts, adjustments can be made either:-

- I. Adjusted through prepare Profit and Loss Adjustment Account
- II. Directly adjusted in capital account of partners in whose account is affected(Table method/Adjusted by passing a single journal entry)

- *Following question and solution give an idea about past adjustments and P & L Adjustment A/C*
- On march 31st 2016, Capital accounts of A, B and C after making adjustments for profits, drawings etc were as A-Rs 8,00,000, B- Rs 6,00,000 and C Rs.4,00,000. Subsequently it was discovered that interest on capital and drawings had been omitted. The partners were entitled to interest on capital, @5% per annum. The drawings during the year were A Rs.2,00,000, b Rs.1,50,000 and C- Rs.90,000. Interest on drawings chargeable to the partners was A-Rs.5,000, B- Rs 3,600 and C Rs.2000. The net profit during the year amounted to Rs 12,00,000 The profit sharing ratio was 3:2:1. Record necessary adjustment entries for rectifying the above errors and omissions.

Past Adjustments-P & L Adjustment A/C

1.Profit and Loss Adjustment A/C Method

Step-1 If the item of omission is interest on capital,first ascertain the opening capital. This is because interest on capital is always calculated on opening capital. If capital given is closing capital,in order to find out opening capital,following procedures should be adopted:-

Closing Capital	XXXX
Add:Drawings	XXXX
Interest on drawings (if any)	<u>XXXX</u>
Less:Profit already credited	<u>XXXX</u>
Opening Capital	<u>XXXX</u>



In this problem opening capital is not given. So we want to calculate opening capital to find out interest on capital.

Step-1 Calculate opening Capital

Particulars	A	B	C
Closing Capital	800000	600000	400000
Add: Drawings	<u>200000</u>	<u>150000</u>	<u>90000</u>
	1000000	750000	490000
Less: Profit already credited	600000	400000	200000
Opening Capital	<u>400000</u>	<u>350000</u>	<u>290000</u>

Interest on capital of A , $4,00,000 \times 5\% = 20000$

Interest on capital of B, $3,50,000 \times 5\% = 17500$

Interest on capital of C, $2,90,000 \times 5\% = 14,500$

Find out the value of interest on capital

Past Adjustments-P & L Adjustment A/C

Step-2 Works out the amount of omitted items which are to be credited to partner's capital account such interest on capital, partners salary, commission, etc. In this problem only interest on capital (credit side items) is omitted Pass the following journal entry to rectify the omission of interest on capital:-

Profit and Loss Adjustment A/C	Dr	52000	
To A's Capital A/C			20000
To B's Capital A/C			17500
To C's Capital A/C			14500

(Rectification entry to adjust interest on capital)

Correction



Past Adjustments-P & L Adjustment A/C

Step-3 Works out the amount of omitted items which are to be debited to partner's capital account such interest on drawings. Pass the following journal entry for the same:

A's Capital A/C	Dr	5000	
B's Capital A/C	Dr	3600	
C's Capital A/C	Dr	2000	
To Profit and Loss Adjustment A/C			10600

(Rectification entry to adjust interest on drawings)

Int. On Drawings Corrected

Past Adjustments-P & L Adjustment A/C

Step-4 Find out the balance of Profit and Loss Adjustment A/C .The credit balance in the Profit and Loss Adjustment A/C reflects profit and debit balance reflect loss. This is to be distributes among partners in their profit sharing ratio:

(a) If it is a credit balance (profit)

Profit and Loss Adjustment A/C	Dr	xxxx	
To, Partner's Capital A/C (Individually)			xxxx
(Transfer of credit balance of P & L Adjustment A/C)			

(b) If it is a debit balance (Loss)

Partner's Capital A/C	Dr (Individually)	xxxx	
To, Profit and Loss Adjustment A/C			xxxx
(Transfer of debit balance of P & L Adjustment A/C)			

Past Adjustments-P & L Adjustment A/

C Step-4 Find out the balance of Profit and Loss Adjustment A/C .The credit balance in the Profit and Loss Adjustment A/C reflects profit and debit balance reflect loss. In this problem debit balance is higher. This is to be distributes among partners in their profit sharing ratio:

(a) Loss distributed:

A's Capital A/C Dr	5000
B's Capiyal A/C Dr	3600
C's Capital A/C Dr	2000
To Profit and Loss Adjustment A/C	10600
(Rectification entry to adjust interest on drawings)	

Balance of P & L Adjustment A/C Distributed

Profit and Loss adjustment A/C

Particulars	Amount	Particulars	Amount
To A's Capital	20000	By A's capital	5000
To b's Capital	17500	By B's Capital	3600
To C's Capital	14500	By C's Capital	2000
		By A's capital	20700
		By B's Capital	13800
		By C's Capital	6900
	<u>52000</u>		<u>52000</u>

Problem Solved
Capital A/C Balance cleared

Partners Capital Account

Particulars	A	B	C	Particulars	A	B	C
To P&L				By Balance b/d	800000	600000	400000
Adjustment A/C	5000	3600	2000	By P&L			
To P&L				Adjustment A/C	20000	17500	14500
Adjustment A/C	20700	13800	6900				
To Balance c/d (b/f)	794300	600100	405600				
	<u>820000</u>	<u>617500</u>	<u>414500</u>		<u>820000</u>	<u>617500</u>	<u>414500</u>

Now the capital Account showed the correct balance

Past Adjustment

2. Directly adjusted in capital account of partners/ Corrected through passing a single journal entry

Due to omission or wrong treatment the capital accounts of partners reflect wrong balances. Some partners capital account over credited(gaining partners) and some partners capital accounts under credited(sacrificing partners).In this method we need to prepare only a statement to find out the net effect of omissions or commissions. Then debit the capital account of the partner whose account is over credited(gaining partner) and credit the capital account of the partner whose capital account is under credited(sacrificing partner).The adjustment journal entry is as follows:-

Gaining Partner's Capital A/C	Dr	xxxx	
To, Sacrificing Partner's Capital A/C			xxxx

(Adjustment journal entry to rectify omissions and errors)

PAST ADJUSTMENTS

Statement Showing Net Adjustment

Particulars	Name of the Partners(On partners point of view)			Total (On firms point of view)
	X	Y	Z	
Interest on capital to be credited	Cr	Cr	Cr	Dr
Interest on drawings to be debited	Dr	Dr	Dr	Cr
Salary to be Credited	Cr	Cr	Cr	Dr
Calculate Net effect of the total column				(Dr/Cr)
Amount(Net effect) in the total column distributed among partners in their ratio [if net effect column shows debit balance here also debit]	Dr/ Cr(depe nds on net effect column)	Dr/Cr	Dr/Cr	-
Net effect of the partners column	Dr/Cr	Dr/Cr	Dr/Cr	-

Past adjustment -Table Method

Q. On March 31st 2016, Capital accounts of A, B and C after making adjustments for profits, drawings etc were as A-Rs 8,00,000, B- Rs 6,00,000 and C Rs.4,00,000. Subsequently it was discovered that interest on capital and drawings had been omitted. The partners were entitled to interest on capital, @5% per annum. The drawings during the year were A Rs.2,00,000, B Rs.1,50,000 and C Rs.90,000. Interest on drawings chargeable to the partners was A -Rs.5,000, B Rs 3,600 and C Rs.2000. The net profit during the year amounted to Rs 12,00,000. The profit sharing ratio was 3:2:1. Record necessary adjustment entry for rectifying the above errors and omissions.

Past Adjustment-Table Method

Particulars	Name of the Partners(On partners point of view)			Total (On firms point of view)
	A	B	C	
Interest on capital to be credited	20000 (Cr)	17500 (Cr)	14500 (Cr)	52000 (Dr)
Interest on drawings to be debited	5000 (Dr)	3600 (Dr)	2000 (Dr)	10600 (Cr)
Calculate Net effect of the total column				41400 (Dr)
Amount(Net effect) in the total column distributed among partners in their ratio 3:2:1	20700 (Dr)	13800 (Dr)	6900 (Dr)	-
Net effect of the partners column	5700 (Dr)	100 (Cr)	5600 (Cr)	-

A's Capital A/C Dr5700
To, B's Capital A/C100
To, C's Capital A/C5600
(Adjustment entry to rectify omission)

Here the rectification journal entry is

A's Capital A/C Dr	5700
To, B's Capital A/C	100
To, C's Capital A/C	5600
(Adjustment entry to rectify omissions)	

Effect of the above journal entry is

A's Capital before rectification is 8,00,000. This balance is incorrect. Preparation of table revealed that to get correct figure A's capital account should be debited by Rs.5700. B's capital was Rs 6,00,000. To correct B's capital it should be credited by Rs.100. C's capital was Rs.4,00,000. To correct C's capital it should be credited by Rs.5600.

Capital Account Balance Before Correction	Correction Required(Dr/ Cr)	Capital Balance After correction
A-8,00,000(Credit)	5700(Dr)	7,94,300(Cr)
B-6,00,000(Credit)	100(Cr)	6,00,100(Cr)
C-4,00,000(Credit)	5600(Cr)	4,05,600(Cr)

Q.Anil,Binil and Sunil are partners in a firm sharing profit and losses in the ratio of 5:3:2.Their fixed capitals were Rs.3,00,000, Rs.2,00,000 and Rs.1,00,000 respectively. For the year 2017 interest on capital was credited to them @ 10% per annum instead of 6% per annum

Particulars	Name of the Partners(On partners point of view)			Total (On firms point of view)
	Anil	Binil	Sunil	
Interest on capital over credited 4% to be debited	12,000 (Cr)	8,000 (Cr)	4,000 (Cr)	24,000 (Dr)
Calculate Net effect of the total column				24,000 (Dr)
Amount(Net effect) in the total column distributed among partners in their ratio 5:3:2 (24,000)	12,000 (Dr)	7,200 (Dr)	4,800 (Dr)	-
Net effect of the partners column	0	800 (Cr)	800 (Dr)	-

Journal Entry

Sunil's Capital A/C Dr 800

To Binil's Capial A/C 800

(Adjustment journal entry to rectify the error)



Correction



X,Y and Z are partners share profits in the ratio of 3:2:1.The profit of the last three years were Rs.1,40,000,RS.84,000 and Rs.1,06,000 respectively. These profits were by mistake shared equally for all the three years. It is now decided to correct the error. Give necessary journal entry for the same.

Particulars	Name of the Partners(On partners point of view)			Total (On firms point of view)
	X	Y	Z	
Profit wrongly credited to be debited (To cancel the mistake)3,30,000 (1:1:1)	1,10,000 (Dr)	1,10,000 (Dr)	1,10,000 (Dr)	3,30,000 (Cr)
Calculate Net effect of the total column				3,30,000 (Cr)
Amount(Net effect) in the total column distributed among partners in their ratio 3,30,000 (3:2:1)	1,65,000 (Cr)	1,10,000 (Cr)	55,000 (Cr)	-
Net effect of the partners column	55,000 (Cr)	0	55,000 (Dr)	-

Journal Entry

Z's Capital A/C Dr 55,000

To X's Capial A/C 55,000

(Adjustment journal entry to rectify the error)



Correction





BINOY GEORGE

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