

# TOPIC: ACCOUNTING FOR FUNDAMENTALS NOTES

## 1. Topics to be covered

- a. Definition of Partnership, Partnership Deed & Characteristics
- b. Profit & Loss Appropriation A/c
- c. Format of Capital Account
- d. Interest on Loan and Rent to partner
- e. Interest on Drawings
- f. Interest on Capital
- g. Past Adjustment
- h. Guarantee of Profit to Partner

## 2. Definition: Section 4 of Indian Partnership Act 1932

When **TWO OR MORE** than two partners **AGREED** to work together to share the **PROFITS** of the **BUSINESS** carried **ON BY ALL AND ANY OF THEM ACTING FOR ALL**.

- a. **Partners:** To form a partnership there should be two or more than two partners

### Key Points:

- i) Minor can be admitted only for Profit
- ii) 6 Months' time to accept or refuse after that he will be liable for all the acts of the firm's
- iii) Maximum No. of Partners: Section 464 of Companies Act 2013 = 100 Partners  
However, it empowers the CG to make appropriate rules regarding this provision  
**As per Rule 10 of Companies Misc. Rules 2014 = 50 Partners**
- b. **Agreement:** Agreement can be in oral or written form known as partnership deed or Articles of Partnership. It is optional. However, in case of any legal proceedings only written form is admissible.
- c. **Sharing of Profits:** There must be sharing of profits.
- d. **Legal Business:** There must be a legal business. Ex. 4 members decided to share the profits in agreed ratio of illegal business of Drugs is not a partnership.
- e. **Mutual Agency:** It refers to relationship of **Principal & Agent**. It means that business is carried on by all and any of them acting for all. Ex. A Partner of partnership from India visits America for Business meetings. That partner is free to take decisions there which should be binding on all the partners provided that the decisions should be in favour of firm.

## 3. Rights of Partners:

- a. To inspect books of accounts
- b. To take participation in management of business
- c. Right to get share in profit & losses
- d. Right to take decision regarding business.

## 4. Liabilities of Partners

- a. **Anti-competitive agreement violation:** If a partner starts same business without the consent of other partners then the profit shall be distributed among all the partners, while in case of loss he shall be personally liable.

- b. If a partner misappropriate amount from partnership and invest somewhere else, then the **profit** should be sharing among all partners.
- c. However, in case of **Loss** the partner who had misappropriated the amount should be bear the loss.

**5. Contents of Partnership Deed**

- a. Name and address of the business
- b. Nature of the business
- c. Name, contacts and address of the partners
- d. Rate of Interest on Capital, drawings and loans
- e. Profit sharing Ratio

**6. Importance of Partnership Deed**

- a. Help to settle the disputes on the basis of partnership deed
- b. Governs the rights, liabilities and duties

**7. Provisions of Partnership Act 1932 applies where partnership deed does not exist.**

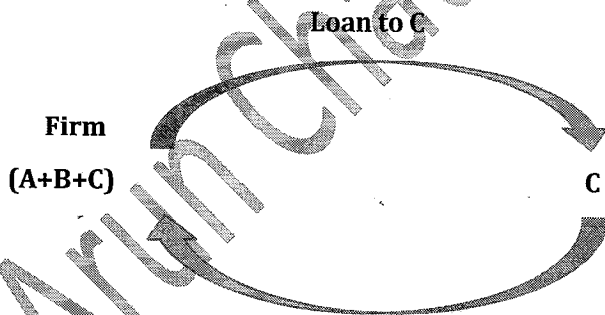
| Matters                 | Provisions                        |
|-------------------------|-----------------------------------|
| Interest on Loan        | 6% p.a. (Loan by partner to firm) |
| Interest on Capital     | Not allowed                       |
| Interest on Drawing     | Not Charged                       |
| Sharing of profits      | Equally                           |
| Remuneration to partner | Not Allowed                       |

**Others:**

- a. New Partner can be admitted only when all the partner agreed.
- b. All the remaining decisions should be decided by majority.
- c. Partnership firm is a separate legal entity only for accounting purpose and not for the Legal point of view.

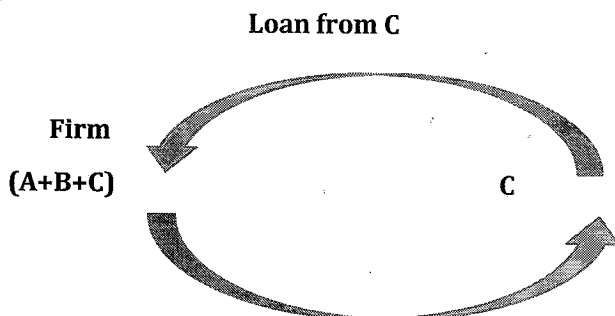
**Imp: Interest on Loan**

**Case: 1**



**No interest will be allowed**  
As there was no agreement

**Case: 2**



**Interest will be allowed**

As C helped the Firm in Financial crunch, hence its moral responsibility of the firm to give at least 6% p.a. interest on Loan

### 8. Journal Entries for Interest on Loan

#### a. Interest on Loan by Partner

##### i) Charging Interest on Loan

Interest on Loan A/c Dr.  
To Partner Loan A/c

##### ii) Closing Entry

Profit & Loss A/c Dr.  
To Interest on Loan A/c

#### b. Interest on Loan to Partner

##### i) Charging Interest on Loan

Partner Capital A/c Dr.  
To Interest on Loan

##### ii) Closing Entry

Interest on Loan A/c Dr.  
To Profit & Loss A/c

### How financial Statements of Partnership Firm are prepared?

JOURNAL

LEDGER

TRIAL BALANCE

PROFIT & LOSS ACCOUNT

PROFIT & LOSS APPROPRIATION ACCOUNT

PARTNERS CAPITAL ACCOUNT

BALANCE SHEET

Already studied at 11<sup>th</sup> Class Level

12<sup>th</sup> Class

### 9. Profit & Loss Appropriation A/c

It is prepared after Profit & loss account for distributing the remuneration and divisible profit between partners **except Interest on Loan & Rent to partner**. It is prepared in case of profit only.

Exception: It can be prepared in case of loss only when Interest on drawings is charged from partner so as to compute the reduced Loss incurred by the firm.

Profit & Loss Appropriation Account  
For the year ended 31<sup>st</sup> March \_\_\_\_\_

| Dr.  | Rs. | Cr.                       | Rs. |
|--|-----|---------------------------|-----|
| Particulars  |     | Particulars               |     |
| To Interest on capital   |     | By Profit & Loss A/c      |     |
| To Salary  |     | Add: Interest on Drawings |     |
| To Commission (Except Manager Commission as it is charge against profit) |     |                           |     |
| To General Reserve   |     |                           |     |
| To Profit transferred to Capital A/c                                     |     |                           |     |
| ↑<br><b>Divisible Profit</b>   |     |                           |     |

**10. Format of Capital Account**

**a. Fixed Capital Method**

| Dr.                                  | Capital Account |   | Cr.                                  |
|--------------------------------------|-----------------|---|--------------------------------------|
| Particulars                          | A               | B | Particulars                          |
| To Bank ( <b>Capital Withdrawn</b> ) |                 |   | Balance b/d                          |
| Balance c/d                          |                 |   | Bank (Additional Capital introduced) |

**Note:**

**Capital account is changed only two times:**

Additional capital introduced

Capital withdrawn

| Dr.                                 | Current A/c |   | Cr.                             |
|-------------------------------------|-------------|---|---------------------------------|
| Particulars                         | A           | B | Particulars                     |
| To balance b/d (if any)             |             |   | Balance b/d                     |
| To Bank ( <b>Profit withdrawn</b> ) |             |   | Profit & Loss Appropriation A/c |
| Interest on drawings                |             |   | Salary                          |
| To Profit & Loss Appro. (Loss)      |             |   | Commission                      |
| Balance c/d                         |             |   | Interest on capital             |

Note: All the items except additional capital & capital withdrawn should be transferred in current account

**b. Fluctuating Capital**

| Dr.                                  | Capital A/c |   | Cr.                                  |
|--------------------------------------|-------------|---|--------------------------------------|
| Particulars                          | A           | B | Particulars                          |
| To Bank ( <b>Capital Withdrawn</b> ) |             |   | Balance b/d                          |
| To Bank ( <b>Profit withdrawn</b> )  |             |   | Bank (additional Capital introduced) |
| Interest on drawings                 |             |   | Profit & Loss Appropriation A/c      |
| To Profit & Loss Appro. (Loss)       |             |   | Salary                               |
| Balance c/d                          |             |   | Commission                           |
|                                      |             |   | Interest on capital                  |

**11. Rent to Partner:** These are the charge against profit i.e., debited to Profit & Loss account as an expense.

**Journal Entries**

- a. Rent A/c Dr.  
    To Rent Payable A/c
- b. Rent Payable A/c Dr.  
    To Bank A/c
- c. Profit & Loss A/c Dr.  
    To Rent A/c

**12. Interest on Drawings:**

**Types of Drawings**

**Drawings of Capital**

**Permanent Nature**

Hence no Interest on drawings  
is Charged

**Drawings of Profit**

**Temporary Nature**

Hence Interest on drawings  
is charged

Ex: Amount withdrawn on 01.10.2024

| Out of Capital |                                | Out of Profit |  |
|----------------|--------------------------------|---------------|--|
| 01.10.2024     | Capital A/c Dr.<br>To Bank A/c | 01.10.2024    | Drawings A/c Dr.<br>To Bank A/c  |
| 31.03.2025     | Nil                            | 31.03.2025    | Capital A/c Dr.<br>To Drawings A/c   |
|                |                                |               | Hence Drawings out of profit is deducted from capital at the end of the year |

**Journal**

- a. Partner Capital /Current A/c Dr.  
    To Interest on Drawings A/c  
  
(Being interest charged)
- b. Interest on drawing A/c Dr.  
    To Profit & Loss Appropriation A/c  
  
(Being interest on drawing transferred)

**Formula = Total Drawings \* Rate/100\***

Time

**Type of Drawings**

Regular Drawings

Irregular Drawings/unequal amount

Time Left after first drawing + Time left after last Drawing

Product Method

2

This formula is applicable in all the cases where the amount is withdrawn at regular intervals

**Note**

- a. If the time period of amount withdrawn is not given, then Interest on drawing is calculated for 6 months.
- b. Interest on drawings is charged on Profit withdrawn.
- c. In case of product method interest is calculated for 1 month or 1 day.

**A Calculation of No. of Months in case of Regular Drawings**

a. If a partner withdrew in the beginning of every Month

$$\frac{\text{Time Left after first drawing} + \text{Time left after last Drawing}}{2}$$

$$(12M+1M)/2 = 6.5M$$

b. If a partner withdrew in the mid of every Month

$$\frac{\text{Time Left after first drawing} + \text{Time left after last Drawing}}{2}$$

$$(11.5M+0.5M)/2 = 6 M$$

c. If a partner withdrew at the end of every Month

$$\frac{\text{Time Left after first drawing} + \text{Time left after last Drawing}}{2}$$

$$(11M+0M)/2 = 5.5 M$$

d. If a partner withdrew at the beginning of every Quarter

$$\frac{\text{Time Left after first drawing} + \text{Time left after last Drawing}}{2}$$

$$(12M+3M)/2 = 7.5 M$$

e. If a partner withdrew in the mid of every Quarter

$$\frac{\text{Time Left after first drawing} + \text{Time left after last Drawing}}{2}$$

$$(10.5M+1.5M)/2 = 6 M$$

f. If a partner withdrew at the end of every Quarter

$$\frac{\text{Time Left after first drawing} + \text{Time left after last Drawing}}{2}$$

$$(9M+0M)/2 = 4.5 M$$

g. If date of Drawings is not specified then the interest on Drawings will be charged for 6 Months

**B. In case of Irregular Drawings: Product Method**

When Varying Amounts Are Withdrawn at Different Intervals

| Date          | Amount | Time Period | Product  |
|---------------|--------|-------------|----------|
| April 1, 2016 | 16,000 | 12 months   | 1,92,000 |
| June 30, 2016 | 15,000 | 9 months    | 1,35,000 |
| Oct. 31, 2016 | 10,000 | 5 months    | 50,000   |
| Dec. 31, 2016 | 14,000 | 3 months    | 42,000   |
| Mar. 1, 2017  | 11,000 | 1 month     | 11,000   |
| Total         |        |             | 4,30,000 |

Total of products × Rate × 1M/12M

$$= \text{Rs. } 4,30,000 \times \frac{7}{100} \times \frac{1}{12} \times \frac{3010}{12} = \text{Rs. } 2,508 \text{ (approx.)}$$

### 13. Interest on Capital

#### Journal Entry

- a. Interest on Capital A/c Dr.  
     To Capital/Current A/c  
 (Being Interest on capital allowed)
  
- b. Profit & Loss Appropriation A/c Dr.  
     To Interest on Capital A/c  
 (Being interest transferred to Profit & Loss Appropriation A/c)

| Situations  | Treatment   |
|---|---|
| Where question is silent                                      | Interest on capital is Appropriation of Profit as all the incomes of partners are appropriation of Profit in normal cases. However, there are with certain exceptions |
| Where question specified that Interest on capital as a charge | Debited to Profit as loss account as specially specified  |
| Where partnership deed doesn't exist                          | Not allowed (Refer Provisions)  |

#### Note:

- i. if Closing capital is given in question then first calculate opening Capital.
- ii. if drawings are given in adjustment, then the same is deducted from Capital during the year.
- iii. if the drawings are given at Assets side, then the same is not deducted. Just remember Provision for Doubtful Debts. Provision for Doubtful is a Liability but for better presentation its deducted from Debtors Similarly Drawings Are Assets but deducted from Capital for better presentation.
- iv. Interest on capital is allowed on capital in fixed capital system.

### 14. Past Adjustments

While preparing the books of accounts of any partnership firm, a lot of attention is given to the fact that there are no errors so that the final results display the financial information accurately. If these errors come in notice before preparing the final accounts, they can be easily rectified for any past adjustments.

Types of Errors to be rectified in Past Adjustments:

- a. Interest on capital not given
- b. Interest on Drawings not charged
- c. Salary or remuneration not given
- d. Excess Interest on Capital allowed
- e. Excess interest on drawings charged

| Particulars                          | A    |      | B    |      | Firm |     |
|--------------------------------------|------|------|------|------|------|-----|
|                                      | Dr.  | Cr.  | Dr.  | Cr.  | Dr.  | Cr. |
| Interest on Cap now credited         |      | -    |      | -    | -    |     |
| Interest wrongly credited            | -    |      | -    |      |      | -   |
| Interest on Drawings now debited     | -    |      | -    |      |      | -   |
| Interest on Drawings wrongly debited |      | -    |      | -    | -    |     |
| Salary now given                     |      | -    |      | -    | -    |     |
| Profit now correctly distributed     |      | -    |      | -    | -    |     |
| Total                                | 1000 | 1200 | 1400 | 1200 |      |     |
|                                      |      | 200  | 200  |      |      |     |

B's Capital A/c Dr. 200

To A's Capital 200

**Note: If Profit was distributed in incorrect ratio, then its compulsory to take profit back**

| Particulars                          | A    |      | B    |      | Firm |     |
|--------------------------------------|------|------|------|------|------|-----|
|                                      | Dr.  | Cr.  | Dr.  | Cr.  | Dr.  | Cr. |
| Profit wrongly credited              | -    |      | -    |      |      | -   |
| Interest on Cap now credited         |      | -    |      | -    | -    |     |
| Interest wrongly credited            | -    |      | -    |      |      | -   |
| Interest on Drawings now debited     | -    |      | -    |      |      | -   |
| Interest on Drawings wrongly debited |      | -    |      | -    | -    |     |
| Salary now given                     |      | -    |      | -    | -    |     |
| Profit now correctly distributed     |      | -    |      | -    | -    |     |
| Total                                | 1000 | 1200 | 1400 | 1200 |      |     |
|                                      |      | 200  | 200  |      |      |     |

#### 10. Guarantee to Partner:

A partner may be admitted into the firm with a guarantee of minimum profit, which means that if his share of profit is less than that of guaranteed profit, then he would be paid the guaranteed share of profit.

The deficiency (difference between guaranteed profit and actual profit) is borne by partner or partners who have guaranteed the profit in agreed ratio.

Different conditions regarding guarantee of profit are:

- (i) Guarantee by the firm to a partner.
- (ii) Guarantee by one partner to another partner.
- (iii) Guarantee given by the partner to the firm.
- (iv) Simultaneous guarantee by the firm to the partner and by the partner to the firm. Steps Involved in the

#### Distribution of Profits under Guarantee Arrangement

Step 1 Calculate the actual share of profit/loss of guaranteed partner.

Step 2 Calculate the guaranteed amount.

Step 3 Calculate the amount of deficiency

Deficiency = Guaranteed Amount – Actual Share of Profit

Step 4 Distribute the deficiency among the guaranteeing partners in their guaranteeing ratio.

Step 5 Distribute the actual profits/losses among all the partners in their profit sharing ratio as if there is no guarantee arrangement.

Step 6 Recover share of deficiency (as per step 3) from the guaranteeing partners and give credit for the same to guaranteed partner.

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