Accounting for Partnership Firms - Fundamentals

Question 1.

In the absence of Partnership Deed, what are the rules relating to:

a. Salaries of partners,

b. Interest on partner's capitals,

c. Interest on partner's loan,

d. Division of profit, and

e. Interest on partners' drawings?

Solution:

	Items	Provision in the Absence of Partnership Deed
(a)	Salaries to Partners	No salary will be allowed to partners.
(b)	Interest on Partner's Capital	No interest will be allowed to partners on their capital.
(c)	Interest on Partner's Loan	6% p.a. interest will be allowed on the money given by partners to the firm in the form of loans and advances.
(d)	Distribution of Profit	Profits will be shared equally, irrespective of the amount of capital contributed by partners.
(e)	Interest on Partner's Drawings	No interest will be charged on the drawings of partners.

Question 2.

Following differences have arisen among P, Q and R. State who is correct in each case:

a. P used Rs.20,000 belonging to the firm and made a profit of Rs.5,000. Q and R want the amount to given to the firm?

b. Q used Rs.5,000 belonging to the firm and suffered a loss of Rs.1,000. He wants the firm to bear the loss

c. P and Q want to purchase goods from A Ltd., R does not agree?

d. Q and R want to admit C as partner, P does not agree?

Solution:

a. P is bound to pay Rs.20,000 along with profit of Rs.5,000 to the firm because this amount belongs to the firm. Explanation: According to the principal and agent relationship, P is principal as well as agent to the firm and to Q and R. As per the rule, any profit earned by an agent (P) by using the firm's property is attributable to the firm.

b. Q is liable to pay Rs.5,000 to the firm. According to the Partnership Act, every partner of a partnership firm is liable to the firm for any loss caused by his/her wilful negligence.

Explanation: Here, Q is solely responsible for the loss of Rs.1,000 because he used the property of the firm and also represented himself as a principal rather than an agent to the other partners and to the firm.

c. P and Q may buy goods from A Ltd.

Explanation: According to the Partnership Act, a partner has a right to buy and sell goods without consulting the other partners unless a Public Notice has been given by the partnership firm to restrict the partners to buy and sell.

d. C will not be admitted because one of the partners, P, has not agreed to admit C. Explanation: According to the Partnership Act, a new partner cannot be admitted into a firm unless all the existing partners agree on the same decision. In other words, a new partner can be admitted in a partnership firm with the consent of all the existing partners.

Question 3.

A, B C are partners in a firm. They have no partnership agreement for their guidance. At the end of the first of the commencement of the firm, they have faced the following problems:

a. A wants that interest on capital should be allowed to the partners but B and C do not agree.

b. B wants that the partners should be allowed to draw salary but A and C do not agree.

c. C wants that the loan given by him to the firm should bear interest @ 10% p.a. but A and B do not agree.

d. A and B having contributed larger amounts of capital, desire that the profits should be divided in the ratio of their capital contribution but C does not agree.

State how you will settle these disputes if the partners approach you for the purpose.

Solution:

	Disputes	Possible Judgements
a.	A wants that interest on capital should be allowed to the partners, but B and C do not agree.	According to the Partnership Act, no interest on capital will be allowed. Reason: There is no partnership agreement among A, B and C regarding interest on capital.
b.	B wants that the partners should be allowed to draw salary, but A and C do not agree.	No salary will be allowed to any partner. Reason: There is no partnership agreement.
c.	C wants that the loan given by him to the firm should bear interest @ 10% p.a., but A and B do not agree.	Interest on partner's loan (C's loan) will be allowed at 6% p.a. Reason: According to the Partnership Act, in the absence of a partnership agreement, interest on a partner's loan is allowed at 6% p.a.
d.	A and B having contributed larger amounts of capital, desire that the profits should be divided in the ratio of their capital contribution, but C does not agree.	Profit will be shared equally and not in the capital ratio. Reason: There is no partnership agreement.

Question 4.

M and N are partners in a firm. M has given a loan of Rs.8,000 to the firm on 1st July, 2016. The Partnership Deed is silent upon the question of provision of interest on partner's loan. Compute the amount of interest payable on the loan advanced by M to the firm, assuming the books are closed on 31st March each year.

Solution:

Amount of loan given by M to the firm (on 1 July 2016) = ₹8,000
Period (from 1 July 2016 to 31 March 2017) = 9 months interest rate = 6% p.a.

$$\therefore \text{ Interest on M's Loan } = 8{,}000 \times \frac{6}{100} \times \frac{9}{12}$$
$$= ₹360$$

Note: In case the partnership agreement is silent, according to the Partnership Act, interest on loan is allowed at 6% p.a. on the amount advanced or loan given by a partner to the firm.

Question 5.

A and B are partners in a firm sharing profits equally. They had advanced to the firm a sum of Rs.30,000 as a loan in their profit-sharing ratio on 1st October, 2015. The Partnership Deed is silent on the question of interest on the loan from partners. Compute the interest payable by the firm to the partners, assuming the firm closes its books on 31st March each year.

Solution:

$$\text{Amount advanced by each partner} = 30{,}000 \times \frac{1}{2}$$
$$= ₹15{,}000$$

Period (from October 01, 2015 to March 31, 2016) = 6 months
Interest rate = 6% p.a. (in the absence of partnership deed)

$$\text{Interest on Loan to each partner} = 15{,}000 \times \frac{6}{100} \times \frac{6}{12}$$
$$= ₹450$$

A and B will get ₹450 individually as interest on loan for 6 months at 6% p.a.

Question 6.

Mahesh and Ramesh are partners with capitals of Rs.50,000 and Rs.60,000 respectively. On 1st January, 2016, Mahesh gives a loan of Rs.10,000 and Ramesh introduced Rs.20,000 as additional capital. Profit for the year ended 31st March, 2016 was Rs.15,200. There is no Partnership Deed. Both Mahesh and Ramesh expect interest @ 10% p.a. on the loan and additional capital advanced by them.

Show how the profits would be divided? Give reasons.

Solution:

Profit and Loss Account

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on Mahesh's Loan		150	By Net Profit b/d	15,200
To Profit transferred to :				
Mahesh's Capital A/c	7,525			
Ramesh's Capital Ac	7,525	15,050		
		15,200		**15,200**

Working Note:
1 Calculation of Interest on Mahesh's Loan
Amount of Loan given by Mahesh = ₹10,000
Period (from Jan 01 to March 31, 2016) = 3 months

$$\therefore \text{ Interest on Mahesh's Loan} = 10{,}000 \times \frac{6}{100} \times \frac{3}{12}$$
$$= ₹150$$

2: Calculation of Interest on Capital
No interest on Capital will be allowed to the partners

Note: There is no partnership deed between Mahesh and Ramesh. Therefore, as per Partnership Act:
a. Interest on Loan will be allowed at 6% p.a.
b. No interest on Partners' Capital will be allowed and
c. Profit after Interest on Mahesh's loan will be distributed equally between Mahesh and Ramesh.

Question 7.

Black and White are partners with capitals of Rs.30,000 and Rs.20,000 respectively. Profits for the year ended 31st March, 2015 amounted to Rs.27,100. It is agreed that 5% interest on capital as such shall be allowed. There is no agreement regarding sharing of profits or partnership salary. Black is a whole-time partner whereas White does not attend business regularly. Black claims Rs.600 salary per month and 60% of balance profits. White advanced Rs.10,000 as loan and he now claims 10% interest. State how you will settle the accounts.

Solution:

Profit and Loss Account

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on Partner's Capital:			By Net Profit b/d (27,100 - 600)	26,500
Black	1,500			
White	1,000	2,500		
To Profit transferred to :				
Black's Capital A/c	12,000			
White's Capital Ac	12,000	24,000		
		26,500		**26,500**

Working Notes :

WN 1 Calculation of Interest on Capital

$$\therefore \text{ Interest on Black's Capital } = 30{,}000 \times \frac{5}{100} = ₹1{,}500$$

$$\therefore \text{ Interest on White's Capital } = 20{,}000 \times \frac{5}{100} = ₹1{,}000$$

WN 2 Calculation of Interest on White's Loan

$$\therefore \text{ Interest on White's Loan } = 10{,}000 \times \frac{6}{100} = ₹600$$

Notes:

1. As per Partnership Agreement, interest on capital to the partners is to be allowed at 5%.
2. There is no partnership agreement for interest on loan provided by the partner. Hence, interest on loan is allowed at 6%.
3. There is no partnership agreement for salary to the partners, therefore no salary will be provided to any of the partner.
4. Also, in the absence of a partnership agreement regarding sharing of profits and losses, profits will be shared equally by the partners.

Question 8.

Jaspal and Rosy were partners with capital contribution ofRs.10,00,000 and Rs.5,00,000 respectively. They do not have a Partnership Deed. Jaspal wants that profits of the firm should be shared in their capital ratio. Rosy convinced Jaspal that profits should be shared equally. Explain how Rosy would have convinced Jaspal for sharing the profit equally.

Solution:

In the absence of a partnership deed, the provisions of the Indian Partnership Act, 1932, apply. According to the Act, if there is no agreement regarding the ratio in which profits are to be shared, then profits (or losses) are to be shared equally among all the partners. Therefore, in this situation, Jaspal's view of distribution of profits in the capital ratio is not acceptable, and Rosy must have convinced her stating the provisions contained in the Partnership Act, 1932.

Question 9.

Jagmohan and Ramesh were partners with capital contribution of Rs.10,00,000 and Rs.5,00,000 respectively. They do not have a Partnership Deed. Jagmohan wants that the firm should allow interest on capital @ 6% p.a. Ramesh convinced Jagmohan that interest cannot be allowed on capital to which Jagmohan agreed after discussion. What argument must have been put forward by Ramesh that convinced Jagmohan?

Solution:

In the absence of a partnership deed, the provisions of the Indian Partnership Act, 1932, apply. According to the Act, if there is no agreement regarding the interest on capital contributed by the partners, then no interest on capital is allowed to any of the partners. Therefore, in this situation, Jagmohan's view of allowing interest on capital at 6% p.a. is not acceptable, and Ramesh must have convinced him stating the provisions contained in the Partnership Act, 1932.

Question 10.

Sunil and Jatinder were partners in a firm. Their drawings during the year were Rs.1,00,000 and Rs.75,000 respectively. They do not have a Partnership Deed. Jatinder wanted that the firm should charge interest drawings @ 6% p.a. Sunil convinced Jatinder that interest cannot be charged on drawings to which Jatind agreed after discussion. What argument must have been put forward by Sunil that convinced Jatind

Solution:

In the absence of a partnership deed, the provisions of the Indian Partnership Act, 1932, apply. According to the Act, if there is no agreement regarding the interest on drawings withdrawn by the partners, then no interest on drawings is charged from any of the partners. Therefore, in this situation, Jatinder's view of charging interest on drawings is not acceptable, and Sunil must have convinced him stating the provisions contained in the Partnership Act, 1932.

Question 11.

Manpreet and Jaspreet were partners sharing profits and losses in the ratio of 3:2. They decided the from 1st April, 2015 they will share profits and losses equally. On that date, the Balance Sheet of the firm had credit balance of Rs.1,00,000 in General Reserve. Jaspreet was of the opinion that it should be credits to the Capital Accounts equally. Manpreet was of the opinion that it should be credited to the Capital Accounts in their old profit-sharing ratio. Jaspreet agreed to the views of Manpreet. Explain what arguments must have been put forward by Manpreet to which Jaspreet agreed.

Solution:

At the time of change in the profit-sharing ratio, on one hand, some partners gain, while on the other hand, some partners sacrifice. Therefore, to avoid putting any partner to an undue advantage or disadvantage, any balance available in the form of accumulated profits and losses is transferred to the Partners' Capital Accounts in their old profit-sharing ratio. So, the balance of Rs.1,00,000 (General Reserve) will be credited to the capital accounts of Manpreet and Jaspreet in the ratio of 3:2. Manpreet must have stated the above accounting practice to Jaspreet to convince her.

Question 12.

Ayub and Anita were partners sharing profits and losses in the ratio of 3:2. They decided that from 1st April, 2015 they will share profits and losses equally. On that date, Revaluation Account was prepared. It was noticed that an unrecorded asset (Computer Printer) valued at Rs.5,000 existed. Ayub was of opinion that it should be credited to the Revaluation Account. Anita was of the opinion that it should be credited to the Capital Accounts in equal proportion. Anita agreed to the views of Ayub. Explain what arguments must have been put forward by Ayub to which Anita agreed.

Solution:

At the time of change in the profit-sharing ratio, any asset found unrecorded is credited to the Revaluation Account and the net result of the Revaluation Account (revaluation profit or revaluation loss) is debited/credited to the Partners' Capital Accounts in their old profit-sharing ratio. Ayub must have stated the above accounting practice to Anita to convince her.

Question 13.

Abhay and Anirudh were partners sharing profits and losses in the ratio of 2:1. They decided that 1st April, 2015 they will share profits and losses equally. On that date, Revaluation Account was prepa It was noticed that an unrecorded liability towards Leave Encashment of Rs.15,000 existed. Abhay was the opinion that it should be debited to the Revaluation Account. Anirudh was of the opinion that it should not be brought into books but should be accounted when it is paid. Abhay explained to Ani the need for it being accounted now and what effect it will have when it is accounted at the time payment. Anirudh agreed to his view point. Explain what arguments must have been put forward by Abhay to which Anirudh agreed.

Solution:

At the time of change in the profit-sharing ratio, any liability found unrecorded is debited to the Revaluation Account and the net result of the Revaluation Account (revaluation profit or revaluation loss) is debited/credited to the Partners' Capital Accounts in their old profit-sharing ratio. In this manner, the partners are not put to any undue advantage or disadvantage. Also, according to the prudence concept, all probable losses should be anticipated. Abay must have stated the above accounting practice (rationale to account now) to Anirudh to convince him.

Question 14.

A and B are partners. A's Capital is Rs.1,00,000 and B's Capital is Rs.60,000. Interest on capital is payable @ 6% p.a. B is entitled to a salary of Rs.3,000 per month. Profit for the current year before interest and salary to B is Rs.80,000.
Prepare Profit and Loss Appropriation Account.

Solution:

Profit and Loss Appropriation Account

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on Capital:			By Profit and Loss (Net Profit)	80,000
A	6,000			
B	3,600	9,600		
To Salary to B (3,000 × 12)		36,000		
To Profit transferred to :				
A's Capital A/c	17,200			
B's Capital A/c	17,200	34,400		
		80,000		**80,000**

Working Notes :

WN 1: Calculation of Interest on Capital

$$\text{Interest on A's Capital} = 1{,}00{,}000 \times \frac{6}{100} = ₹6{,}000$$

$$\text{Interest on B's Capital} = 60{,}000 \times \frac{6}{100} = ₹3{,}600$$

WN 2:
Calculation of Profit Share of each Partner
Divisible Profit = 80,000 - 9,600 - 36,000 = 34,400

$$\text{Profit Share of A and B each} = 34{,}400 \times \frac{1}{2}$$
$$= ₹17{,}200$$

Question 15.

X, Y and Z are partners in a firm sharing profits in 2 : 2 : 1 ratio. The fixed capitals of the partners were Rs. 5,00,000; Y Rs.5,00,000 and Z Rs.2,50,000. The Partnership Deed provides that interest on capital should be allowed @ 10% p.a. and that Z should be allowed a salary of Rs.2,000 per month. The profits of the firm form the year ended 31st March, 2015 after debiting Z's salary were Rs.4,00,000.

Prepare Profit and Loss Appropriation Account.

Solution:

Profit and Loss Appropriation Account

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on Capital			By Profit and Loss A/c (Net Profit after Z's salary)	4,00,000
X	50,000			
Y	50,000			
Z	25,000	1,25000		
To Profit transferred to :				
X's Capital A/c	1,10,000			
Y's Capital A/c	1,10,000			
Z's Capital A/c	55,000	2,75,000		
		4,00,000		**4,00,000**

Working Notes :

1 Salary to Z has not been debited to Profit and Loss Appropriation Account because Profit of ₹4,00,000 is given after adjusting the Z's salary.

2 Calculation of Interest on Capital

$$\text{Interest on X's Capital} = 5{,}00{,}000 \times \frac{10}{100} = ₹50{,}000$$

$$\text{Interest on Y's Capital} = 5{,}00{,}000 \times \frac{10}{100} = ₹50{,}000$$

$$\text{Interest on Z's Capital} = 2{,}50{,}000 \times \frac{10}{100} = ₹25{,}000$$

3 Calculation of Profit Share of each Partner
Divisible of Profit after Interest on Capital = ₹4,00,000 - ₹1,25,000 = ₹ 2,75,000

Profit sharing ratio = 2 : 2: 1

$$\text{X's Profit Share} = 2{,}75{,}000 \times \frac{2}{5} = 1{,}10{,}000$$

$$\text{Y's Profit Share} = 2{,}75{,}000 \times \frac{2}{5} = 1{,}10{,}000$$

$$\text{Z's Profit Share} = 2{,}75{,}000 \times \frac{1}{5} = 55{,}000$$

Question 16.

On 1st April, 2013, Jay and Vijay entered into partnership for supplying laboratory equipments' government schools situated in remote and backward areas. They contributed capitals of Rs.80,000 and; Rs.50,000 respectively and agreed to share the profits in the ratio of 3:2. The Partnership Deed provided that interest on capital shall be allowed at 9% per annum. During the year the firm earned a profit of Rs.7,800.

Showing your calculations clearly, prepare 'Profit and Loss Appropriation Account' of Jay and Vijay for the year ended 31st March, 2014.

Solution:

Profit and Loss Appropriation Account
For the year ended March 2014

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on Capital A/c			By Profit and Loss A/c	7,800
Jay	4,800			
Vijay	3,000	7,800		
		7,800		**7,800**

Working Notes :

1 Calculation of Interest on Capital

$$\text{Interest on Jay's Capital} = 80{,}000 \times \frac{9}{100} = ₹7,200$$

$$\text{Interest on Vijay's Capital} = 50{,}000 \times \frac{9}{100} = ₹4,500$$

$$\text{Total Interest} = 7{,}200 + 4{,}500 = ₹11,700$$

2 Calculation of Proportionate Interest on Capital

$$\text{Proportionate Interest to Jay} = \frac{7,200}{11,700} \times 7,800 = ₹4,800$$

$$\text{Proportionate Interest to Vijay} = \frac{4,500}{11,700} \times 7,800 = ₹3,000$$

Note :
Interest on capital is to be treated as an appropriation of profits and is to be provided to the extent of available profits i.e. ₹7,800

Question 17.

Amit and Vijay started a partnership business on 1st April, 2015. Their capital contributions we Rs.2,00,000 and Rs.1,50,000 respectively. The Partnership Deed provided inter alia that:

a. Interest on capital @ 10% pa.

b. Amit to get a salary of Rs.2,000 per month and Vijay Rs.3,000 per month.

c. Profits are to be shared in the ratio of 3:2.

Profit for the year ended 31st March, 2016 before making above appropriations was Rs.2,16,000. Interest on drawings amounted to Rs.2,200 for Amit and Rs.2,500 for Vijay.

Prepare Profit and Loss Appropriation Account.

Solution:

Profit and Loss Appropriation Account

Dr. Cr.

Particulars		₹	Particulars		₹
To Interest on Capital:			By Profit and Loss A/c (Net Profit)		2,16,000
Amit	20,000		By Interest on Drawings A/c		
Vijay	15,000	35,000	Amit	2,200	
Salary to :			Vijay	2,500	4,700
Amit (2,000 × 12)	24,000				
Vijay (3,000 × 12)	36,000	60,000			
To Profit transferred to :					
Amit's Capital A/c	75,420				
Vijay's Capital A/c	50,280	1,25,700			
		2,20,700			**2,20,700**

Working Notes :

WN 1: Calculation of Interest on Capital

$$\text{Interest on Amit's Capital} = 2{,}00{,}000 \times \frac{10}{100} = ₹20{,}000$$

$$\text{Interest on Vijay's Capital} = 1{,}50{,}000 \times \frac{10}{100} = ₹15{,}000$$

WN 2: Calculation of Profit Share of each Partner
Divisible Profit = 2,16,000 + 4,700 - 35,000 - 60,000 = ₹1,25,700
Profit sharing ratio = 3 : 2

$$\text{Amit's Profit Share} = 1{,}25{,}000 \times \frac{3}{5} = ₹75{,}420$$

$$\text{Vijay's Profit Share} = 1{,}25{,}000 \times \frac{2}{5} = ₹50{,}280$$

Question 18.

A, B and C were partners in a firm having capitals of Rs.50,000; Rs.50,000 and Rs.1,00,000 respectively. Their Current Account balances were A: Rs.10,000; B: 5,000 and C: 2,000 (Dr.). According to the Partnership Deed the partners were entitled to an interest on Capital @ 10% p.a. C being the working partner was also entitled to a salary of Rs.12,000 p.a. The profits were to be divided as:

a. The first Rs.20,000 in proportion to their capitals.

b. Next Rs.30,000 in the ratio of 5 : 3 : 2.

c. Remaining profits to be shared equally.

The firm made a profit of Rs.1,72,000 before charging any of the above items.

Prepare Profit and Loss Appropriation Account and pass necessary Journal entry for the appropriation of profits.

Solution:

Profit and Loss Appropriation Account

Dr. Cr.

Particulars		₹	Particulars	₹
To Interest on Capital			By Profit and Loss A/c (Net Profit)	1,72,000
A	5,000			
B	5,000			
C	10,000	20,000		
To Salary to C		12,000		
To Profit transferred to :				
A's Capital A/c	50,000			
B's Capital A/c	44,000			
C's Capital A/c	46,000	1,40,000		
		1,72,000		**1,72,000**

Journal Entries

Date	Particulars		L.F.	Debit ₹	Credit ₹
	Interest on Capital A/c	Dr.		20,000	
	To A's Current A/c				5,000
	To B's Current A/c				5,000
	To C's Current A/c				10,000
	(Being Interest on partner's capital allowed to partners)				
	Salary A/c	Dr.		12,000	
	To C's Current A/c				12,000
	(Being Salary Allowed to C)				
	Profit and Loss Appropriation A/C	Dr.		1,40,000	
	To A's Current A/c				50,000
	To B,s Current A/c				44,000
	To C's Current A/c				46,000
	(Being profit available for distribution transferred to partners' current account)				