Financial Accounting II

As per new B Com CBCS syllabus 2017 for CU

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Foreword

The subject of Accounting has undergone manifold changes in the recent past, which necessitates constant updating and modifications of course content of this discipline.

The book titled 'Financial Accounting II', authored by Abhik Kr. Mukherjee and Soumya Mukherjee, has been written keeping an eye on the current syllabi of the University of Calcutta. The lucid presentation of the conceptual aspects and the graded illustrations are expected to develop interest of the students in the subject and also help them understand the subject easily.

I firmly believe that this book will fulfill the need of the student community and will also be of great interest to the academicians associated with this discipline.

I take this opportunity to congratulate the authors for their sincere efforts in preparing the book and I hope that such endeavor of the authors will be successful in serving the purpose for which it has been written.

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Features of

Adjustment for Interim Period's Profit/Loss

- Usually the retirement of a partner is planned at the end of an accounting pe
  date the operating result (i.e. profit/loss) of the firm for the period is ascertai
  capital accounts.
- However, in certain situations, an existing partner may decide to retire du
  accounting period. In that case for determining the amount due to the r
  loss of the accounting period till the date of retirement (i.e. profit/loss of
  considered.
- For this purpose, the following steps are to be observed:
  1. Ascertain/estimate the profit/loss of the firm and retiring partner's s
     period.
  2. This interim profit is to be accounted for in any one of the following two

Theory explained in lucid language using unique bulleted format
The theoretical concepts of each chapter are vividly discussed using unique bulleted format.

Topics updated with relevant Accounting Standards
The topics of the syllabus (both theory and numerical illustrations) have been updated with the provisions of the relevant Indian Accounting Standards (Ind AS).

13.10 CONCEPT OF 'LEASE'

- **Lease** is defined as a contractual agreement by which one entity (the owner
  entity the right to use the asset for a specific period in return for periodical
  understanding that the said asset shall revert back to the owner at the end of t
  stated, the term 'lease' refers to renting of a fixed asset for a specified period. It
  financing in the modern business world.
- **Parties involved in lease:** Two parties are involved in a lease agreement. They
  - **Lessor:** The owner of a leased asset is referred to as the *Lessor*. In other wor
    grants a lease.
  - **Lessee:** The party that uses the leased asset is referred to as the *Lessee*.
- In a lease agreement, the ownership of the asset remains with the lessor, whe
  use to the lessee. In consideration for such usage, the lessee has to pay a fixed a
  Rental) periodically to the lessor.
- In India, accounting for leases is governed by AS-19 (*Accounting for Leases*) a

GRADED ILLUSTRATIONS

llustration 1: ***Individual Life Policies – Retirement of a partner – C***

, N, and O were partners in a firm sharing profits and losses in the r
olicies in the name of the partners individually for ₹2,00,000, ₹1,5
tired on Mar. 31, 2018, while M and O decided to share future profit
lue of each life policy is 20% of the sum assured. Give the requ
dependent cases:
) The life policy accounts appear in the Balance Sheet at their surren

Graded Illustrations
The worked-out problems of each chapter have been arranged in a graded structure (i.e., from easy numerical problems to advanced numerical problems).

the Book

Student Note

Apportionment of Certain Specific Ex

- **Interest on Purchase Consideration/In**
amount payable by the acquiring orga
payable by the acquiring/buying organ
of the said purchase consideration. It is to be noted tl

Concept Note: Domestic Branch vs Foreign Branch

Conceptually, domestic and foreign branches can be differen

- **Location:** A domestic branch is established in the sam established in a country other than the country of its H.O.
- **Nature:** Domestic branches can be either dependent or ind
- **Currency:** The transactions and accounting of a domestic H.O. is situated; whereas the transactions and accounting

Student Notes & Concept Notes
Each chapter contains Concept Notes and Student Notes on relevant points for enhancing the conceptual clarity of the readers.

Problem Note

In this case, as the incoming partner is temporar
Loan A/c has been opened in his name.
Moreover, when he brings the required premiun
Bank A/c Dr.
To 8% C's Loan A/c

Problem Notes
A unique feature of this book is the inclusion of Problem Notes for most of the worked out illustrations. This will help students in conceptual understanding of the concepts.

Chapter-end Exercises
Each chapter contains questions for students to practise.

EXERCISES

1. State the basis on which the following common expenses, the benefit of whic is distributed among the departments: (i) Rent, rates and taxes, insurance of b discount, bad debts, selling commission and other such selling expenses; (iii) (v) Interest on loan; (vi) Profit or loss on sale of investment; (vii) Wages; (v
2. Give the basis of allocation of the following common expenditure among differ (i) Insurance of building; (ii) Discount and bad debts; (iii) Discount received; (iv) assets; (v) Advertisement expenses; (vi) Labour welfare expenses; (vii) PF/ESI
3. Surya Co. Ltd. has three departments. It made purchases during the financial y

READY ACCESS TO EXAMINATION PROBLEMS

C.U. B.COM	Illustration No	Professional Courses
1996 (Hons)	13	CA Foundation Nov.1997
2001 (Hons)	16	ICWA Inter Dec. 2004
2004 (Gen.)	8	ICWA Inter Dec. 2006
2005 (Hons)	17	CA PCC May 2007

Ready Access to Examination Problems
This unique table presents the questions set in the past examinations (CU B. Com and Professional Courses) for easy access.

Preface

The responsibility of recording the financial events entered into by any kind of organization is on the discipline of accountancy. It is the 'language' using which the happenings of an organization are communicated to its stakeholders. Financial accounting happens to be one of the core subjects of any commerce and business faculty. Accountancy is an age-old subject which is regularly evolving in this 'ever changing' world. In this era of globalization, accountancy, as a discipline, is undergoing significant transformation. In the modern era it is getting transformed from 'principle-based' to 'rule-based'.

ABOUT THE BOOK

We are pleased to present before the academic community our second effort on this subject—a book titled *Financial Accounting II*. The aim of this book is to help the students solidify their conceptual base of the subject and bring clarity in understanding some of the advanced topics of the discipline of financial accountancy.

This book is primarily intended to cater to the needs of the students undergoing Bachelor of Commerce course (Honours and General) in different universities, specifically University of Calcutta (CU). It has been developed as per the newly introduced semester-based CBCS syllabus (2017) of CU. Moreover, it will also guide the students pursuing different professional courses viz. CA, CS, CMA, and MBA.

PEDAGOGICAL FEATURES

Some of the distinguishing features of the book are:

- The first **self-study textbook** of Financial Accounting for students of CU
- **Student-friendly approach** in theory and worked-out problems
- Theoretical discussion in **lucid language** and in innovative **bulleted form**
- Inclusion of **Concept Note** and **Student Note** for relevant points across all chapters
- **As many as 400 worked illustrations** in **self-understandable approach** with Problem Notes and detailed Working Notes
- Relevant **problems set at C.U. B.Com [Hons** and **Gen.]** examination and **professional examinations [CA, CS, CMA]** of last three decades
- Chapter-end **Exercises** for practising the contents discussed in the chapter
- **Ready Access Table** to past examination problems

CONTENT AND STRUCTURE

This book covers the entire syllabus of Financial Accounting II of CU over 17 chapters. These chapters may be divided into the following broad areas:

- **Partnership Accounting (Chapter 1 through Chapter 10)**: The first section of the book provides detailed discussion of various aspects of partnership accounting viz. finalization of partnership firms (including appropriation and distribution of profits), valuation and accounting for goodwill, accounting for life policies, different aspects of accounting for change in constitution of the firm (i.e. admission, retirement, death of partner and change in profit sharing ratio between the partners) and dissolution of partnership firms (including piecemeal distribution).

- **Accounting for Responsibility Centres (Chapter 11, Chapter 12 and Chapter 14)**: It is a common practice amongst organizations to operate through various responsibility centres viz. branches and departments. Accounting of each such responsibility centre involves special principles. Chapter 11 (Accounting for Dependent Branches) and Chapter 12 (Accounting for Independent Branches) of this title deal with the various facets of Branch Accounting. Chapter 14 titled 'Departmental Accounting' focuses on the finalization of accounts (i.e. determination of operating results and disclosure of financial position) by an organization that operates through various departments.
- **Accounting for Asset-related Special Transactions (Chapter 13 and Chapter 15)**: Chapter 13 discusses certain special systems relating to acquisition of fixed assets viz. hire-purchase system, instalment payment system and lease. On the other hand, Chapter 15 discusses accounting with regard to investments made in financial assets viz. shares, debentures, etc.
- **Accounting for Business Acquisition (Chapter 16 and Chapter 17)**: The final two chapters of this title deal with transactions that arise in the event of acquisition of a business by another business. Specifically stated, Chapter 16 discusses and presents in detail the accounting for profit/loss arising prior to incorporation of an entity, while Chapter 17 deals with the accounting in the books of the selling firm and the acquiring firm in the event of a business acquisition.

While every attempt has been made to make this title comprehensive and error free, there may remain some areas which require further development. In this regard, any suggestion or improvement can be sent to us directly to our e-mail address: mukherjeeandmukherjee@gmail.com.

Abhik Kr. Mukherjee
Soumya Mukherjee

Contents

Road Map to CU B Com Syllabus

CC3.1Ch: Financial Accounting – II

Unit	Topic	Details	Chapter
1	Partnership accounts-I	Correction of appropriation items with retrospective effect. Change in constitution of firm – change in P/S ratio, admission, retirement and retirement cum admission – treatment of Goodwill, revaluation of assets & liabilities (with/without alteration of books), treatment of reserve and adjustment relating to capital; treatment of Joint Life Policy, Death of a partner	Chapters 1 to 8
2	Partnership accounts-II	Accounting for dissolution of firm – insolvency of one or more partner, consideration of private estate and private liabilities. Piecemeal distribution – surplus capital basis; maximum possible loss basis.	Chapters 9 & 10
3	Branch accounting	Concept of Branch; different types of Branches. Synthetic method – preparation of Branch account. Preparation of Branch Trading and P/L account. (at cost & at IP) – normal and abnormal losses. Analytical method – preparation of Branch Stock, Adjustment etc A/C (at cost & at IP) – normal & abnormal losses Independent branch – concept of wholesale profit	Chapters 11 & 12
4	Hire purchase and Instalment payment system	Meaning; difference with Instalment payment system; Recording of transaction in the books of buyer – allocation of interest – use of Interest Suspense a/c – partial and complete repossession Books of Seller – Stock and Debtors A/C (with repossession) Books of Seller – H.P. Trading A/C without HP Sales and HP Debtors and General Trading A/c (with repossession) Concept of operating and financial lease – basic concept only.	Chapter 13
5	Departmental accounts	Concept, objective of preparation of departmental accounts; apportionment of common cost; Preparation of Departmental Trading and P/L account, Consolidated Trading and P/L account; inter departmental transfer of goods at cost, cost plus and at selling price and elimination of unrealized profit.	Chapter 14
6	Investment accounts	Maintenance of Investment Ledger; Preparation of Investment Account (transaction with brokerage, STT, cum & ex-interest), Valuation of Investment under FIFO and Average method; Investment Account for Shares (with Right Shares, Bonus Shares and Sale of Right). Relevant Accounting Standard.	Chapter 15
7	Business acquisition and Conversion of partnership into limited company	Profit/loss prior to incorporation; Accounting for Acquisition of business. Conversion of Partnership into Limited Company – with and without same set of books	Chapters 16 & 17

1

Partnership Accounting:
Profit & Loss Appropriation

1.1 INTRODUCTION

In the beginning, trade and business were carried on by individual business-man who is referred to as a Sole-proprietor. But with the gradual increase in complexity of the business and trade, it was not always possible for an individual business-man to cope up with the financial and managerial demands. In such situations, more than one person decided to pool together their resources to carry on their business and trade. This led to the development of the partnership form of organization.

1.2 PARTNERSHIP FORM OF BUSINESS

- As per Sec. 4 of the Indian Partnership Act, 1932, the term '**partnership**' refers to 'the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.'
- The persons who have entered into partnership with one another are individually called **Partners**, and they are collectively referred to as the **Firm**.

Essential Elements of Partnership

The essential elements of a partnership that emerge from the above definition may be briefly stated as follows:

1. **Mode of formation:** A partnership form of organization is formed by a contract. It does not arise from status, inheritance, or operation of law.
2. **Contract:** A contract for partnership is a special type of contract.
3. **Two or more persons:** At least two persons (i.e. two or more persons) are required to form a partnership form of organization as it arises from a contract for which a minimum of two persons are required.
4. **No separate entity:** Legally, a partnership firm has no separate entity, i.e. the partners and the firm are considered to be one and the same.
5. **Business:** This essential element of a partnership provides that the persons must have agreed to carry on a business. The term 'business' includes any trade, profession, or occupation.
6. **Profit-motive:** Partnership business should be carried on with a profit-making objective and not for any charitable or social purpose.
7. **Sharing of profits:** Another essential element of a partnership is that the agreement to carry on a business must be with the object of sharing profits amongst all the partners.
8. **Mutual agency:** The partnership business must be carried on by all the partners or any (one or more) of them acting on behalf of all. In other words, there must be mutual agency.
9. **Regulating statute:** In India, partnership form of organizations is governed by the provisions of the Indian Partnership Act, 1932.
10. **Unlimited liability:** The liabilities of the partners of a firm are unlimited. Moreover, each of the partners is jointly and severally (i.e. individually) liable for all the debts of the firm.
11. **Registration:** Registration of a partnership firm is not compulsory under law. However, a registered firm enjoys certain privileges provided under the statute.

Student Note

Limited Liability Partnership (LLP)

- LLP is a special form of business organization that combines the features of partnership as well as joint stock company.

- It is a corporate business vehicle that provides the benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership.
- In this form of business organization, the liability held by each of the partners is limited by law.
- It is a separate legal entity distinct from its partners.
- In India, LLPs are governed by the Limited Liability Partnership Act, 2008.

Partnership Deed

- A partnership form of organization arises from an agreement between two or more persons. Such agreements may be either oral or written or implied from the usual conduct of the partners.
- The written document which contains the various terms of the partnership agreement as agreed amongst the partners and sets forth the various rights and obligations of the partners in the firm is referred to as the **Partnership Deed**.
- Since it provides the rules for the internal management of the firm, it is also known as the 'Articles of Partnership' or the 'Constitution of the Partnership Firm'.
- It has to be signed by all the partners and must be duly stamped as per the provisions of the Indian Stamp Act.
- If there is no partnership deed or the partnership deed is silent regarding any matter, then the relevant provisions of the Indian Partnership Act (as provided u/s 13) would be applicable.

When there is no partnership deed or deed is silent (Application of Sec. 13 of the Indian Partnership Act, 1932)

If there is **no partnership deed or the partnership deed is silent** regarding any matter, then the relevant provisions of the Indian Partnership Act, 1932 (as provided u/s 13) would be applicable. The important provisions that directly affect accounting for partnership firms are as under:

1. **Remuneration to partners [Sec. 13(a)]:** No remuneration is to be allowed to any partner.
2. **Sharing of profits and losses [Sec. 13(b)]:** Profits and losses are to be shared equally.
3. **Interest on capital to partners [Sec. 13(c)]:** No interest on capital is to be allowed to any partner.
4. **Interest on advance/loan given by a partner [Sec. 13(d)]:** Interest on advance/loan given by a partner to the firm is allowed @ 6% p.a.
5. **Interest on Drawings:** No interest on drawings is to be charged by the firm from any partner.

1.3 ACCOUNTING FOR PARTNERSHIP FIRMS

The accounting for a partnership firm is very much similar to that of a sole-proprietorship concern except the following aspects:

- Allocation and apportionment of firm's net profit or loss amongst the partners;
- Distribution of divisible profits amongst the partners (with or without 'Guarantee');
- Maintenance of Partners' Capital Accounts;
- Accounting for change in constitution (in events of admission, retirement, death of partner, change in profit sharing ratio); and
- Dissolution of partnership firm.

NB.: The last two aspects of partnership accounting are not discussed in this chapter as they are beyond its scope.

1.4 FINAL ACCOUNTS OF PARTNERSHIP FORM OF ORGANIZATION

- A partnership form of organization, like any other business, prepares the final accounts at the end of every accounting period for determining its operating results and for disclosing the financial position.

- The components of the final accounts of a partnership form of trading organization are:
  - **Trading Account**: for determination of gross profit/loss;
  - **Profit & Loss Account**: for determination of net profit/loss;
  - **Profit & Loss Appropriation Account**: for allocation and apportionment of its net profit or loss (along with Interest on Drawings, if any) among different heads; and
  - **Balance Sheet**: for disclosing the financial position of the entity.

Allocation and Apportionment of Net Profits or Loss

- A partnership firm prepares a special component as part of its final accounts (after the preparation of Profit & Loss A/c) for the purpose of allocation and apportionment of its net profit or loss (along with Interest on Drawings, if any) among different heads, namely Partners' remuneration (viz. Salary, Bonus, Commission etc.), Interest on Capital etc., and for making transfer to reserves. This component is referred to as the **Profit & Loss Appropriation Account**.
- It is that part of the final accounts that records the 'appropriation items', i.e., those items that occur only when the firm has sufficient profits.
- The different items that appear in the P/L Appropriation A/c are:
  - **In the debit-side:** Partners' Remuneration (viz. Salary, Bonus, Commission, etc.), Interest on Capital, Transfer to Reserves and Distribution of profits amongst the partners.
  - **In the credit-side:** Net profit (as per P/L A/c) and Interest on Drawings.
- **Proforma:**

Dr. **Profit & Loss Appropriation A/c** **Cr.**

Particulars	₹	Particulars	₹
To Partners' Remuneration	***	By Profit & Loss A/c [Net Profit transferred]	***
To Interest on Capital	***	By Interest on Drawings	***
To Reserves (Transfer)	***		
To Partners' Capital A/c [Share of profit]	***		
	****		****

1.5 DIFFERENCES BETWEEN P/L A/C AND P/L APPROPRIATION A/C

Both Profit & Loss A/c and Profit & Loss Appropriation A/c are components of final accounts of partnership form of business organization. However, they can be differentiated as under:

Points of Difference	Profit & Loss A/c	Profit & Loss Appropriation A/c
1. Nature of organization	It is a part of financial statement of every form of profit-oriented organization.	It is a part of financial statement of only two forms of profit-oriented organizations viz. partnership firm and company.
2. Purpose	It is prepared to ascertain the net profit or net loss of the organization.	It is prepared for apportioning (i.e. distributing) the net profit/loss of the organization among the members.
3. Order of preparation	It is prepared prior to the preparation of Profit & Loss Appropriation Account.	It is prepared after the preparation of Profit & Loss Account.
4. Nature of transactions recorded	Transactions which are in the nature of 'charges against profits' are recorded here.	Transactions which are in the nature of 'appropriation of profits' are recorded here.
5. Opening entry	This account begins with the Gross Profit or Gross Loss.	This account begins with the Net Profit or Net Loss.

1.6 ACCOUNTING TREATMENT OF CERTAIN IMPORTANT ITEMS

The accounting for the different items of appropriation of profits of a partnership form of organization are discussed here-under:

Remuneration to Partners (viz. Partners' Salaries, Bonus, Commission, etc.)

- **Partners' remuneration** refers to the amount due to a partner from the firm for the different services that are rendered by the partner to the firm.
- Partners' remuneration includes Partners' Salary, Bonus, or Commission to partner.
- It is an **appropriation of profit**.

Accounting Treatment:

○ This is allowed only if the partnership deed provides for the same.
○ If there is no partnership deed or the partnership deed is silent in this regard, the relevant provision of Sec. 13 of the Partnership Act will be applicable i.e. no remuneration is to be allowed to any partner.
○ It is debited to Profit & Loss Appropriation A/c.

Interest on Capital

- Interest on capital refers to the amount due to the partner(s) from the firm for the capital contribution made by them.
- Since the amounts of capital contributed by the partners in a firm are not always the same, the provision for interest on capital ensures adequate compensation to the partners based on their capital contribution.
- It is an **appropriation of profit**.

Accounting Treatment:

○ This is allowed only if the partnership deed provides for the same.
○ If there is no partnership deed or the partnership deed is silent in this regard, the relevant provision of Sec. 13 of the Partnership Act will be applicable i.e. no interest on capital is to be allowed to any partner.
○ It is debited to Profit & Loss Appropriation A/c.

Interest on Loan

- Interest on loan refers to the amount due to the partner(s) from the firm for the amount advanced by them to the firm over and above their capital contribution.
- It is a **charge against profit** (and **NOT** an appropriation of profit).

Accounting Treatment:

○ This is always allowed to the partner(s), irrespective of the fact that the partnership deed provides for the same or not.
○ If interest on loan is allowed in the partnership deed: Rate of interest on loan will be at the rate specified in the deed.
○ If there is no partnership deed or the partnership deed is silent in this regard: The relevant provision of Sec. 13 of the Partnership Act will be applicable i.e. interest on loan is to be allowed @ 6% p.a.
○ It is debited to Profit & Loss A/c.

Interest on Drawings

- The term 'Drawings' refers to the resources withdrawn by partner(s) from the firm. Such drawings may be either in cash or in kind.

- The drawings made by a partner from the firm may be of two types:
  - **Drawings against Profits:** It refers to the amount withdrawn by partner(s) out of the expected profits of the entity.
  - **Drawings against Capital:** It refers to the amount withdrawn by partner(s) out of the capital of the firm.
- **Interest on Drawings** refers to the amount due to the firm from the partner(s) for the amounts withdrawn by them from the firm.

Accounting Treatment:

- Accounting for interest to be charged on Drawings depends on the fact whether it is 'Drawings against Profits' or 'Drawings against Capital'.

Interest on Drawings against Profits

- Interest on Drawings against Profits is accounted for through Interest on Drawings A/c.
- This is charged only if the partnership deed provides for the same.
- If there is no partnership deed or the partnership deed is silent in this regard, the relevant provision of Sec. 13 of the Partnership Act will be applicable i.e. no interest on drawings is to be charged from any partner.
- It is credited to Profit & Loss Appropriation A/c.

Interest on Drawings against Capital

- Interest on Drawings against Capital is accounted for through Interest on Capital A/c.
- This is charged only if the partnership deed provides for the same.
- If there is no partnership deed or the partnership deed is silent in this regard, the relevant provision of Sec. 13 of the Partnership Act will be applicable i.e. no interest on drawings is to be charged from any partner.

N.B.: When simply, 'Interest on Drawings' is mentioned in the problems, it is to be considered as 'Interest on Drawings against Profits' and treated accordingly.

Student Note

Rules for calculation of Interest on Drawings

- Interest on Drawings is calculated on the amount withdrawn by applying the appropriate rate of interest and considering the relevant time period.
- When equal amount of drawings are made by the partners on monthly basis, the interest on drawings is to be calculated '**on total annual drawings**' for the following periods:

Date of Drawings	Period for which interest is calculated
Beginning (i.e. first day) of each month	6½ months
Middle of each month	6 months
End (i.e. last day) of each month	5½ months
Beginning (i.e. first day) of each quarter	7½ months
Middle of each quarter	6 months
End (i.e. last day) of each quarter	4½ months

- If date of drawings is not mentioned in any problem, then it is to be assumed that drawings have been made evenly in the middle of each month and interest on drawings is to be calculated '**on total annual drawings**' for half-year i.e. for 6 months.

Distribution of Profits and Losses

- A partnership form of business differs from a sole-proprietorship business, primarily on the fact that in case of the former there are more than one owner of the business. This requires the distribution of the profit earned or loss sustained by the business over all the partners.
- The distribution of profits and losses amongst the partners depends on the existence of any '**guarantee clause**' in the partnership deed. [Refer to '**Guarantee of Minimum Profit'** for detailed discussion]

Accounting Treatment:

- The divisible profit or loss is to be distributed amongst the partners as per the provision laid out in the partnership deed.
- If there is no partnership deed or the partnership deed is silent in this regard, the relevant provision of Sec. 13 of the Partnership Act will be applicable i.e. profits and losses are to be shared equally amongst all the partners.
- It is to be transferred from the Profit & Loss Appropriation A/c to Partners' Capital A/c (under Fluctuating Capital Method) or Partners' Current A/c (under Fixed Capital Method).

Student Note

Guarantee Clause (i.e. Guarantee of Minimum Profit)

- **Meaning of Guarantee Clause:** When a new partner (who is apprehensive of the future profit earning capacity of the firm) joins a firm a bit reluctantly, a special clause is incorporated in the deed in order to provide him/her a minimum amount of profit, in case the profits of the firm are not up to the mark. This clause is referred to as the **Guarantee Clause**. Its purpose is to provide some confidence to the newly admitted partner. Such guarantee may be given by any one or more partner(s) of the firm or jointly by all the partners of the firm.
- **Types of Guarantee:** Such guarantees may be of two types:
  - **Personal Guarantee:** When guarantee is given by any one or more partner(s) of the firm; and
  - **Firm Guarantee:** When guarantee is given jointly by all the partners of the firm.
- **Parties of Guarantee Clause**: The partner(s) who give(s) such guarantee of minimum profit is(are) called **Guaranteeing Partner(s);** and
- The new partner to whom the guarantee for minimum profit is provided is referred to as the **Guaranteed Partner**.
- The minimum amount of profit that has been guaranteed is referred to as **Guaranteed Amount.**
- **Implication of Guarantee Clause:** When in any accounting period, the regular share of profit of the Guaranteed Partner falls short of the guaranteed amount, then such shortfall/deficiency is borne by the Guaranteeing Partner(s) in the agreed ratio.

Share of profit for a minor partner

- An individual who has not attained majority (i.e. the age of 18 years) is referred to as a **minor**.
- As per the Partnership Act, a minor may be admitted to the benefits of partnership with the consent of all the other partners of a firm. It implies that a minor is **entitled to get a share of the profits of the firm**, but he/she **will not bear any loss sustained by the firm**.

1.7 MAINTENANCE OF PARTNERS' CAPITAL ACCOUNTS

- The maintenance of partners' capital accounts are required for reflecting the transactions between the partners and the firm.
- There are two methods of maintaining the capital accounts of the partners in the books of a firm. They are:
  1. Fixed Capital Method
  2. Fluctuating Capital Method

Fixed Capital Method

- In this method, **two accounts** are maintained representing each partner viz. **Capital Account** and **Current Account**.
- **Partners' Capital Account** records transactions relating to the introduction of capital and permanent withdrawal of capital.
- Other transactions between the partner and the firm viz. partner's remuneration, interest on capital, interest on drawings share of profit or loss, etc. are recorded through **Partners' Current Account**.
- Since, the balance of the Capital Account remains unaltered from one accounting period to another (except for introduction of capital and withdrawal of capital), this method of maintaining the partners' capital accounts is referred to as the Fixed Capital Method.
- **Proforma:**

Dr. **Partners' Capital A/c** **Cr.**

Particulars	X	Y	Particulars	X	Y
To Bank A/c [Capital withdrawn]	**	**	By Balance b/f	**	**
To Balance c/f	**	**	By Bank A/c [Introduction of further capital]	**	**
	***	***		***	***

Dr. **Partners' Current A/c** **Cr.**

Particulars	X	Y	Particulars	X	Y
To Drawings A/c	**	**	By Balance b/f	**	**
To Interest on Drawings A/c	**	**	By Interest on Capital A/c	**	**
To P/L Appropriation A/c [Share of Loss]	**	**	By Partners' Salary A/c	**	**
To Balance c/f	**	**	By Partners' Commission A/c	**	**
			By P/L Appropriation A/c [Share of Profit]	**	**
	***	***		***	***

Fluctuating Capital Method

- In this method, **a single account** is maintained representing each partner viz. **Capital Account**.
- **Partners' Capital Account** records all the transactions entered into between the partners and the firm during an accounting period.
- Since, the balance of the Capital Account regularly changes or fluctuates, this method of maintaining the partners' capital accounts is referred to as the **Fluctuating Capital Method**.
- **Proforma:**

Dr. **Partners' Capital A/c** **Cr.**

Particulars	X	Y	Particulars	X	Y
To Drawings A/c	**	**	By Balance b/f	**	**
To Bank A/c [Capital withdrawn]	**	**	By Bank A/c [Introduction of further capital]	**	**
To Interest on Drawings A/c	**	**	By Interest on Capital A/c	**	**
To P/L Appropriation A/c [Share of Loss]	**	**	By Partners' Salary A/c	**	**
To Balance c/f	**	**	By Partners' Commission A/c	**	**
			By P/L Appropriation A/c [Share of Profit]	**	**
	***	***		***	***

Journal Entries under different methods of maintenance of partners' capital accounts		
Transaction	**Fixed Capital Method**	**Fluctuating Capital Method**
Interest on capital	Interest on Capital A/c Dr. To Partners' Current A/c	Interest on Capital A/c Dr. To Partners' Capital A/c
	P/L Appropriation A/c Dr. To Interest on Capital A/c	P/L Appropriation A/c Dr. To Interest on Capital A/c
Interest on drawings	Partners' Current A/c Dr. To Interest on Drawings A/c	Partners' Capital A/c Dr. To Interest on Drawings A/c
	Interest on Drawings A/c Dr. To P/L Appropriation A/c	Interest on Drawings A/c Dr. To P/L Appropriation A/c
Remuneration to partner	Partners' Remuneration A/c Dr. To Partners' Current A/c	Partners' Remuneration A/c Dr. To Partners' Capital A/c
	P/L Appropriation A/c Dr. To Partners' Remuneration A/c	P/L Appropriation A/c Dr. To Partners' Remuneration A/c
Share of profit	P/L Appropriation A/c Dr. To Partners' Current A/c	P/L Appropriation A/c Dr. To Partners' Capital A/c

N.B.: For Interest on capital, remuneration to partners' and interest on drawings 'single journal entry' could be passed involving P/L Appropriation A/c and Partners' Capital/Current A/c.

1.8 DIFFERENCES BETWEEN FIXED & FLUCTUATING CAPITAL METHOD

There are two methods of maintaining capital accounts of partners in the books of a firm—Fixed Capital Method and Fluctuating Capital Method. They may be distinguished as under:

Points of Difference	Fixed Capital Method	Fluctuating Capital Method
1. Accounts maintained for each partner	Two accounts are maintained for each partner – Capital A/c and Current A/c.	Only one account is maintained for each partner – Capital A/c.
2. Transactions in Capital Account	In the capital account only two categories of transactions are entered viz. introduction of capital and permanent withdrawal of capital.	All transactions between the partner and the firm (such as, partners' remuneration, interest on capital, share of profits, etc.) are recorded in the capital account.
3. Transactions in Current Account	All transactions between the partner and the firm, (except capital introduction and permanent withdrawal of capital) are recorded in the current account.	The question of recording transactions in Current account does not arise as no Current A/c is maintained.
4. Nature of balance in Capital Account	Partners' capital account always reflects credit balance.	Partners' capital account may reflect credit or debit balance.
5. Change in Capital Account	Generally, the balance of the capital account remains unchanged i.e. fixed over a considerable time period.	Generally, the balance of the capital account changes i.e. fluctuates over the period.

1.9 CERTAIN TYPICAL CASES OF PARTNERSHIP FINAL ACCOUNTS

There arise certain cases, after the preparation of the final accounts of a partnership firm that requires the redistribution of the profits among the partners. Two such situations are discussed as under:

Rectification of Erroneous Distribution of Past Profits/Past Adjustments

- In some cases, certain modifications are required to be made with regard to certain entries that relate to earlier accounting periods and have already been entered in the books of accounts of a firm. These modifications are referred to as '**Past Adjustments**' as they cause a change in the past profits and their distribution.

- **Situations requiring past adjustments**
  Some of the situations that require adjustments in the past profits are:
  - Partners' remuneration/Interest on Capital/Interest on Drawings accounted for in the books even though the partnership deed did not provide the same;
  - Partners' remuneration/Interest on Capital/Interest on Drawings not accounted for in the books though expressly provided in the partnership deed;
  - Incorrect amount of Partners' remuneration/Interest on Capital/Interest on Drawings recorded in the books of accounts;
  - Incorrect distribution of profits amongst the partners;
  - Change in profit sharing ratio with retrospective effect;
  - Omission of certain transactions viz. outstanding expenses, accrued incomes, etc.

Conversion of Basis of Accounting

- Every organization maintains its books of accounts under any one basis of accounting viz. cash basis, or accrual basis, or hybrid basis.
- However, under certain circumstances, a firm may desire to get its books of accounts converted from its present basis to some other basis (i.e. Cash Basis → Accrual Basis; or Cash Basis → Hybrid Basis, etc.).
- This requires re-calculation of incomes and expenses and adjustments with regard to the distributed profits.

GRADED ILLUSTRATIONS

Illustration 1: ***Preparation of P & L Appropriation A/c and Partners' Capital A/c – Interest on capital – Interest on drawings – Partners' Salary***

X, Y and Z are three partners in a firm. According to partnership deed, the partners are entitled to draw up to ₹1,400 per month. On the 1st day of every month, X, Y and Z drew ₹1,400, ₹1,200 and ₹1,000 respectively. Interest on capitals and drawings are fixed at 8% and 10% p.a. respectively. Profit during the year ended 31.03.2018 was ₹1,51,000 out of which ₹40,000 is to be transferred to General Reserve. Y and Z are entitled to receive salary of ₹6,000 and ₹9,000 p.a. respectively and X is entitled to receive commission at 10% on net distributable profit after charging such commission. On 1st April, 2017 the balances of their capital accounts were ₹1,00,000, ₹80,000 and ₹70,000 respectively.

You are required to show the Profit and Loss Appropriation Account for the year ended 31.03.2018 and Capital Accounts of Partners in the books of the firm.

Solution

Books of .... (the firm)

Dr. **P/L Appropriation A/c for the year ended 31.3.2018** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To General Reserve		40,000	By P/L A/c [Net Profit]		1,51,000
To Partners' Salary:			By Interest on Drawings [WN:1]:		
X	6,000		X	910	
Y	9,000	15,000	Y	780	
To Interest on Capital:			Z	650	2,340
X	8,000				
Y	6,400				
Z	5,600	20,000			

To Partner's Com. – X [WN: 2]		7,122			
To Partners' Capital A/c [Divisible Profit]					
X [1/3]	23,739				
Y [1/3]	23,739				
Z [1/3]	23,740	71,218			
		1,53,340			1,53,340

Dr. **Partners' Capital A/c** **Cr.**

	X (₹)	Y (₹)	Z (₹)		X (₹)	Y (₹)	Z (₹)
To Drawings A/c	16,800	14,400	12,000	By Balance b/f	1,00,000	80,000	70,000
To Int. on Drawings A/c	910	780	650	By Partner's Salary A/c	—	6,000	9,000
To Balance c/f				By Int. on Capital A/c	8,000	6,400	5,600
				By Partner's Com. A/c	7,122	—	—
				By P/L Appro. A/c [Divisible Profit]	23,739	23,739	23,740
	1,21,151	1,00,959	95,690		1,38,861	1,16,139	1,08,340

WORKING NOTES

1. **Interest on Drawings**

   Since, drawings were made at the beginning of each month, interest is to be calculated for a period of 6.5 months as under:

   Interest on Drawings: X = ₹(1,400 × 12) ×10% × 6.5/12 = ₹910; Y = ₹(1,200 × 12) × 10% × 6.5/12 = ₹780

   Z = ₹(1,000 × 12) ×10% × 6.5/12 = ₹650

2. **Commission to X**

   X is entitled to receive commission at 10% on net distributable profit after charging such commission.
   Distributable profit before charging X's commission = ₹78,340.
   X's commission = ₹78,340 × 10/110 = ₹7,122

Illustration 2: ***Basic problem – Journal entries, P/L Appropriation A/c and Partners' Capital A/c***

Partners A and B decided to appropriate profits of the firm on the following terms:

(a) Interest is payable on Capital at 5% p.a.
(b) Both A and B will get remuneration at ₹2,000 and ₹1,000 per month respectively.
(c) Interest is payable on loan contributed by A at 6% p.a. (A contributed loan of ₹20,000 to the firm on July 1, 2017).
(d) Interest on Drawings of partners is 4% p.a. (Drawings of A and B during 2017 were ₹6,000 and ₹4,000 respectively).
(e) Profit sharing ratio between A and B is 3:2.

For the year ending on Dec. 31, 2017 the total net profit of the firm is shown at ₹70,000. On Jan. 1, 2017, the Capital balances of A and B were ₹50,000 and ₹40,000 respectively.

In the firm's books show the Journal entries, P/L Appropriation A/c and Capital A/c.

[*C.U. B.Com. (Hons), 1998 – Dates changed*]

Solution

Problem Note **Interest on Loan:** It is a **charge against profit** (and **NOT** an appropriation of profit). So, it will not appear in P/L Appropriation A/c. However, in this problem, as the interest has not yet been accounted for, it will be deducted from the given 'Net Profit' to ascertain the 'Correct Net Profit'.

Books of .... (the firm)
Journal

Date	Particulars		Dr. ₹	Cr. ₹
2017 Dec. 31	Interest on A's Loan A/c	Dr.	600	
	To A's Loan A/c			600
	(Being interest on loan payable to the partners provided for)			
Dec. 31	P/L A/c [₹70,000 – ₹600]	Dr.	600	
	To Interest on A's Loan A/c [₹20,000 × 6% × 6/12]			600
	(Being interest on partners' loan transferred to P/L A/c)			
Dec. 31	P/L A/c	Dr.	69,400	
	To P/L Appropriation A/c			69,400
	(Being the net profit transferred)			
Dec. 31	Interest on Capital A/c	Dr.	4,500	
	To A's Capital A/c [₹50,000 × 5%]			2,500
	To B's Capital A/c [₹40,000 × 5%]			2,000
	(Being interest on capital of the partners' credited to Partners' Capital A/c)			
Dec. 31	P/L Appropriation A/c	Dr.	4,500	
	To Interest on Capital A/c [₹90,000 × 5%]			4,500
	(Being interest on capital of the partners provided)			
Dec. 31	Partners' Salary A/c	Dr.	36,000	
	To A's Capital A/c			24,000
	To B's Capital A/c			12,000
	(Being remuneration payable to the partners credited to Partners' Capital A/c)			
Dec. 31	P/L Appropriation A/c	Dr.	36,000	
	To Partners' Salary A/c [₹24,000 + ₹12,000]			36,000
	(Being remuneration payable to the partners provided for)			
Dec. 31	A's Capital A/c [₹6,000 × 4% × 6/12]	Dr.	120	
	B's Capital A/c [₹4,000 × 4% × 6/12]	Dr.	80	
	To Interest on Drawings A/c			200
	(Being interest on drawings charged to partners)			
Dec. 31	Interest on Drawings A/c [₹10,000 × 4% × 6/12]	Dr.	200	
	To P/L Appropriation A/c			200
	(Being interest on drawings provided for)			
Dec. 31	A's Capital A/c	Dr.	6,000	
	B's Capital A/c	Dr.	4,000	
	To A's Drawings A/c			6,000
	To B's Drawings A/c			4,000
	(Being drawings of partners transferred to capital A/c)			
Dec. 31	P/L Appropriation A/c	Dr.	29,100	
	To A's Capital A/c			17,460
	To B's Capital A/c			11,640
	(Being divisible profit transferred to Partners' Capital A/c)			

Dr. **P/L Appropriation A/c for the year ended Dec. 31, 2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital			By P/L A/c [Net Profit]	70,000	
A [50,000 × 5%]	2,500		*Less*: Int. on loan of A [20,000 × 6% × 6/12]	600	69,400
B [40,000 × 5%]	2,000	4,500	By Interest on Drawings		
To Partners' Salary			A [6,000 × 4% × 6/12]	120	
A [2,000 × 12]	24,000		B [4,000 × 4% × 6/12]	80	200
B [1,000 × 12]	12,000	36,000			
To Partners' Capital A/c [Divisible Profit]					
A (3/5)	17,460				
B (2/5)	11,640	29,100			
		69,600			69,600

Dr. **Partners' Capital A/c** **Cr.**

Particulars	A (₹)	B (₹)	Particulars	A (₹)	B (₹)
To Drawings A/c	6,000	4,000	By Balance b/f	50,000	40,000
To Interest on Drawings A/c	120	80	By Interest on Capital A/c	2,500	2,000
To Balance c/f	87,840	61,560	By Partners' Salary A/c	24,000	12,000
			By P/L Appro. A/c [Share of profit]	17,460	11,640
	93,960	65,640		93,960	65,640

Illustration 3: ***P/L Appropriation A/c – Fixed capital Method – Calculation of correct Net Profit***
P, Q and R are partners sharing profits and losses in the proportion of 4 :3 : 2.
During 2017 their fixed capitals and drawings (including salaries) were as follows:

Partners	Capital (Fixed) (₹)	Drawings (including salaries) (₹)
P	4,80,000	48,000
Q	3,20,000	36,000
R	2,00,000	30,000

Each partner is entitled to a salary of ₹2,000 per month and interest @ 5% p.a. on capital.
At the middle of the year, P made an advance of ₹2,00,000 to the firm bearing interest of 6% p.a.
The net profit for the year ended 31.12.2017 stood at ₹2,18,000 before charging interest on capital and loan but after charging partners' salaries.
Prepare the Profit and Loss Appropriation Account and the Partners' Current Accounts.

Solution **Books of .... (the firm)**

Dr. **P/L Appropriation A/c for the year ended 31.12.2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Partners' Salaries:			By P/L A/c [Net Profit – WN:1]		2,84,000
P	24,000				
Q	24,000				
R	24,000	72,000			
To Interest on Capital:					
P (4,80,000 × 5%)	24,000				
Q (3,20,000 × 5%)	16,000				
R (2,00,000 × 5%)	10,000	50,000			

To Partners' Current A/c [Div. Profit]					
P [4/9]	72,000				
Q [3/9]	54,000				
R [2/9]	36,000	1,62,000			
		2,84,000			2,84,000

Dr. **Partners' Current A/c** **Cr.**

Particulars	P (₹)	Q (₹)	R (₹)	Particulars	P (₹)	Q (₹)	R (₹)
To Partners' Drawings A/c	48,000	36,000	30,000	By Partner's Salary A/c	24,000	24,000	24,000
To Balance c/f	72,000	58,000	40,000	By Interest on Capital A/c	24,000	16,000	10,000
				By P/L Appro. A/c [Div. Profit]	72,000	54,000	36,000
	1,20,000	94,000	70,000		1,20,000	94,000	70,000

WORKING NOTES

Calculation of correct Net Profit (Figs in ₹):	
NP before Interest on capital and loan, but after charging partners' salaries	2,18,000
Add: Partners' Salaries	72,000
∴ NP before Interest on capital and loan	2,90,000
Less: Interest on loan [2,00,000 × 6% × 6/12]	6,000
∴ Correct NP	2,84,000

Illustration 4: ***Concept building problem – Ascertainment of interest on drawings in different situations***

Calculate the Interest on Drawings of X @ 12% p.a. for the year ended Dec. 31, 2017 in each of the following independent situations:

(a) If his drawings during the year were ₹36,000;
(b) If he withdrew ₹3,000 p.m. in the beginning of every month;
(c) If he withdrew ₹3,000 p.m. at the middle of every month;
(d) If he withdrew ₹3,000 p.m. at the end of every month;
(e) If he withdrew the following amounts as follows:
Jan. 31: ₹3,000, **Mar. 31:** ₹6,000, **Aug. 1:** ₹9,000**; Oct. 31:** ₹3,000, **Dec. 1:** ₹5,000
(f) If he withdrew ₹3,000 in the beginning of each quarter;
(g) If he withdrew ₹3,000 during the middle of each quarter;
(h) If he withdrew ₹3,000 at the end of each quarter.

Solution

Problem Note **Use of average period:**
If the drawings made by the partners uniformly and at uniform time interval (e.g. monthly, quarterly etc), 'Average period' could be used instead of month wise separate calculation for interest on drawings. The **average period** could be calculated with the help of following formula:

(a) If fixed amount is withdrawn in the beginning of every month/quarter

$$\frac{[\text{Total period of drawing (in months)} + \text{Times interval between two consecutive drawings (in months)}]}{2}$$

(b) If amount is withdrawn at the end of every month/quarter

$$\frac{[\text{Total period of drawing (in months)} - \text{Times interval between two consecutive drawings (in months)}]}{2}$$

(c) If amount is withdrawn during the middle of every month/quarter

$$\frac{[\text{Total period of drawing(in months)}]}{2}$$

Case (a)

It is assumed that drawings have been made evenly in the middle of each month and hence, interest on drawings is to be calculated '**on total annual drawings**' for half-year i.e. for 6 months.

∴ Interest on drawings = ₹36,000 × 12 % × 6/12 = ₹2,160

Case (b)

As equal amounts of drawings are made by the partner at the beginning of every month, the interest on drawings is to be calculated for [(12 +1)/2] 6½ months '**on total annual drawings**'.

∴ Interest on drawings = ₹(3,000 × 12) × 12 % × 6.5/12 = ₹2,340

Case (c)

As equal amounts of drawings are made by the partner at the middle of every month, the interest on drawings is to be calculated for [12/2] 6 months '**on total annual drawings**'.

∴ Interest on drawings = ₹(3,000 × 12) × 12 % × 6/12 = ₹2,160

Case (d)

As equal amounts of drawings are made by the partner at the end of every month, the interest on drawings is to be calculated for [(12 – 1)/2]5½ months '**on total annual drawings**'.

∴ Interest on drawings = ₹(3,000 × 12) × 12 % × 5.5/12 = ₹1,980

Case (e)

As the partner withdrew different amounts on different dates, interest on drawings is to be calculated as under:

Date of withdrawal	Amount of drawings (₹)	Month of interest	Equivalent amount for 1month
Jan. 31	3,000	11	[3,000 × 11] ≡ ₹33,000
Mar. 31	6,000	9	[6,000 × 9] ≡ ₹54,000
Aug. 1	9,000	5	[9,000 × 5] ≡ ₹45,000
Oct. 31	3,000	2	[3,000 × 2] ≡ ₹6,000
Dec. 1	5,000	1	[5,000 × 1] ≡ ₹5,000
			₹1,43,000

∴Interest on drawings = ₹1,43,000 × 12 % × 1/12 = ₹1,430

Verification:

Interest on drawings

= [₹3,000 × 12 % × 11/12] + [₹6,000 × 12% × 9/12] + [₹9,000 × 12% × 5/12] + [₹3,000 × 12% × 2/12] + [₹5,000 × 12% × 1/12] = ₹1,430

Case (f)

As equal amounts of drawings are made by the partner at the beginning of every quarter, the interest on drawings is to be calculated for [(12 + 3)/2] 7½ months '**on total annual drawings**'.

∴ Interest on drawings = ₹(3,000 × 4) × 12 % × 7.5/12 = ₹900

Case (g)

As equal amounts of drawings are made by the partner at the middle of every quarter, the interest on drawings is to be calculated for [12/2] 6 months '**on total annual drawings**'.

∴ Interest on drawings = ₹(3,000 × 4) × 12 % × 6/12 = ₹720

Case (h)

As equal amounts of drawings are made by the partner at the end of every quarter, the interest on drawings is to be calculated for [(12 – 3)/2] 4.5 months '**on total annual drawings**'.

∴ Interest on drawings = ₹(3,000 × 4) × 12 % × 4.5/12 = ₹540

Illustration 5: ***Interest on capital when profit is insufficient***

Virat and Raina commenced a business on Apr. 1, 2017 contributing capitals of ₹1,50,000 and ₹1,00,000 respectively. They agreed to share profits and losses equally and to allow interest on capital @ 10% p.a. For the year ending Mar. 31, 2018, they made a profit of ₹9,000 before making any allowance for interest on capital. Prepare an account showing the appropriation of profit, if:

(a) they do not make any agreement as to whether interest shall be allowed or not in case of loss or insufficient profit; or

(b) they have agreed that interest shall be allowed at the given rate irrespective of profit.

Solution

Problem Note

Treatment of Interest on capital when profit is insufficient

- If the partnership deed/agreement does not allow to provide for interest on capital in the event of loss or insufficient profit, then **Net Profit is to be divided between the partners in capital ratio** i.e. effectively, interest on capital is allowed to the extent of profit available.
- On the other hand, if the partners agree to consider interest on capital irrespective of profit, then it is to be allowed to the full extent and balancing figure in P/L Appropriation A/c represents 'Divisible Loss'. Such, divisible loss is to be distributed between partners in profit sharing ratio.

(a) No agreement to consider interest on capital in case of insufficient profit

Books of .... (the firm)

Dr. **P/L Appropriation A/c for the year ended Mar. 31, 2018** **Cr.**

Particulars	₹	₹	**Particulars**	₹	₹
To Interest on Capital:			By P/L A/c [Net Profit]		9,000
Virat (3/5)[1]	5,400				
Raina (2/5)[1]	3,600	9,000			
		9,000			9,000

N.B.: [1]Capital ratio of Virat and Raina = 1,50,000 : 1,00,000 = 3:2

(b) Agreement to consider interest on capital irrespective of profit

Books of .... (the firm)

Dr. **P/L Appropriation A/c for the year ended Mar. 31, 2018** **Cr.**

Particulars	₹	₹	**Particulars**	₹	₹
To Interest on Capital			By P/L A/c [Net Profit]		9,000
Virat [1,50,000 × 10%]	15,000		By Partners' Capital A/c [Divisible Loss]		
Raina [1,00,000 × 10%]	10,000	25,000	Virat (1/2)	8,000	
			Raina (1/2)	8,000	16,000
		25,000			25,000

Illustration 6: ***Distribution of profit on effective capital ratio***

A, B, and C started a partnership from Apr. 1, 2017.

A contributed ₹3,000 on Apr. 1, 2017.

B contributed ₹2,000 on Apr. 1, 2017 and thereafter increased his capital to ₹2,500 from Aug. 1, 2017 and then after 4 months on Dec. 1, 2017 he withdrew ₹1,500.

C contributing ₹4,000 on Apr. 1, 2017 withdrew ₹2,500 after 6 months on Oct. 1, 2017.

At the end of the year on Mar. 31, 2018 they made a profit of ₹910. Show how the partners would divide this profit on the basis of the effective capital employed by each partner during the year 2017–18.

[*C.U. B.Com. (Gen.), 2000 – Adapted*]

Solution

Problem Note

Concept of 'Effective Capital Employed'

When the partners invest and withdraw money from the firm on different dates, the amount of capital employed in the business does not remain constant over the period. In such cases, 'Effective Capital employed' in the firm is to be determined as follows:

Effective capital employed = Equivalent capital for 1 month = Amount of capital employed in the business × No. of month(s) of capital employment

Ascertainment of Effective Capital Employed

Partner A:

₹3,000 on Apr. 1, 2017 for entire year i.e. for 12 months ≡ (₹3,000 × 12) for 1 month ≡ ₹36,000 for 1 month

Partner B:

Investment in Capital	Effective Capital for 1 month	
₹2,000 from Apr. 1, 2017 to July 31, 2017 i.e. for 4 months	[₹2,000 × 4] for 1 month ≡	₹8,000
₹2,500 from Aug. 1, 2017 to Nov. 30, 2017 i.e. for 4 months	[₹2,500 × 4] for 1 month ≡	₹10,000
[₹2,500 – ₹1,500] from Dec. 1, 2017 to Mar. 31, 2018 i.e. for 4 months	[₹1,000 × 4] for 1 month ≡	₹4,000
	∴ Total Effective Capital	₹22,000

Partner C:

Investment in Capital	Effective Capital for 1 month	
₹4,000 from Apr. 1, 2017 to Sept. 30, 2017 i.e. for 6 months	[₹4,000 × 6] for 1 month ≡	₹24,000
[₹ 4,000 – ₹2,500] from Oct. 1, 2017 to Mar. 31, 2018 i.e. for 6 months	[₹1,500 × 6] for 1 month ≡	₹9,000
	∴ Total Effective Capital	₹33,000

Ratio of Effective Capital Employed

∴ Ratio of effective capital employed among the partners = 36,000:22,000:33,000 = 36:22:33

∴ Distribution of Profit among the partners: A = 910 × 36/91 = ₹360; B = 910 × 22/91 = ₹220;
C = 910 × 33/91 = ₹330

Illustration 7: ***Application of Partnership Act in the absence of Partnership Deed – Preparation of P/L Appropriation A/c***

Ram, Rahim, and Karim are partners in a firm. They have no agreement in respect of profit sharing ratio, interest on capital, interest on loan, advanced by partners and remuneration payable to partners. In the matter of distribution of profit they have put forward the following claims:

(i) Ram, who has contributed maximum capital demands interest on capital at 10% p.a. and share of profit in the capital ratio. However, Rahim and Karim do not agree.

(ii) Rahim has devoted full time for running the business and demands salary at the rate of ₹500 p.m. but Ram and Karim do not agree.

(iii) Karim demands interest on Loan ₹2,000 advanced by him at the market rate of interest which is 12% p.a.

How shall you settle the dispute and prepare P/L Appropriation A/c.

You are required to show the settlement of the dispute and prepare the P/L Appropriation A/c provided that:

- Net profit before taking into account any of the above claims, amounted to ₹45000 at the end of the 1st year of their business.
- 10% of divisible profit is to be transferred to Reserve Fund. **[*C.U. B.Com. (Hons), 1994*]**

Solution

Problem Note **Interest on Loan:** It is a **charge against profit** (and **NOT** an appropriation of profit). So, it will not appear in P/L Appropriation A/c. However, in this problem, as the interest has not yet been accounted for, it will be deducted from the given 'Net Profit' to ascertain the 'Correct Net Profit'.

Settlement of dispute:

As there is no agreement between the partners regarding interest on capital, interest on loan, advanced by partners and remuneration payable to partners, then the relevant provisions of the Indian Partnership Act, 1932 (as provided u/s 13) would be applicable. They are as under:

1. **Interest on capital to partner [Sec. 13(c)]:** No interest on capital is to be allowed to any partner. So, Rahim's claim regarding interest on capital cannot be accepted.
2. **Sharing of profits and losses [Sec. 13(b)]:** Profits and losses are to be shared equally. So, Ram's claim to share profits in capital ratio is not at all accepted.
3. **Remuneration to partner [Sec. 13(a)]:** No remuneration is to be allowed to any partner. So, Rahim's demand for salary will not be accepted.
4. **Interest on advance/loan given by a partner [Sec. 13(d)]:** Interest on advance/loan given by a partner to a firm is allowed @ 6% p.a. So, Karim's demand for interest on loan at 12% is not acceptable.

Books of .... (the firm)

Dr. P/L Appropriation A/c for the year ended..... Cr.

Particulars	₹	₹	Particulars	₹	₹
To Reserve Fund [44,880 × 10%]		4,488	By P/L A/c [Net Profit as given]	45,000	
To Partners' Capital A/c [Divisible Profit]			*Less*: Interest on Loan [2,000 × 6%]	120	44,880
Ram (1/3)	13,464				
Rahim (1/3)	13,464				
Karim (1/3)	13,464	40,392			
		44,880			44,880

N.B.: it is assumed that the loan was provided from the beginning of the year.

Illustration 8: ***Past adjustment – Interest on capital omitted from books of account***

P, Q, R, and S are partners sharing profits and losses in the ratio of 4:3:2:1 and their respective capitals on Dec. 31, 2017 were ₹30,000, ₹45,000, ₹60,000, and ₹45,000. After closing and finalizing the accounts it was found that interest on capital @ 10% per annum was omitted to be recorded. Instead of altering the signed accounts it was decided to pass a single adjusting entry on Jan. 1, 2018 by crediting or debiting the respective partners' accounts. Show the journal entry. **[*C.U. B.Com. (Hons) – Adapted*]**

Solution

Problem Note In this problem, opening capital and amount of profit which has already been distributed is not given. So, it is not possible to ascertain 'Opening Capital' from 'Closing Capital'. But, we know that interest on capital is to be charged on Partners' opening capital balance. In this circumstance, it has to be assumed that the firm maintains the capital accounts under 'Fixed Capital Method'. So, the 'Closing Capital' balance could be considered as 'Opening Capital' balance assuming the partners did not withdraw or introduce any fresh capital into the business during the year.

Books of .... (the firm)

Journal

Date	Particulars		Dr. ₹	Cr. ₹
1.1.18	P's Current A/c	Dr.	4,200	
	Q's Current A/c	Dr.	900	
	To R's Current A/c			2,400
	To S's Current A/c			2,700
	(Being rectification of wrong distribution of profit – WN:1)			

WORKING NOTES

1. **Adjustment of partners for omission of interest on capital**

   P = ₹30,000 × 10% = ₹3,000

   Q = ₹45,000 × 10% = ₹4,500

   R = ₹60,000 × 10% = ₹6,000

   S = ₹45,000 × 10% = ₹4,500

   ∴ Total interest on capital = ₹3,000 + ₹4,500 + ₹6,000 + ₹4,500 = ₹18,000. Such interest amount was distributed among P, Q, R, and S in profit sharing ratio, it is to be written back and it is again to be distributed in capital ratio.

2. **Distribution of interest on capital**

	P (₹)	Q (₹)	R (₹)	S (₹)
Interest on capital which is to be distributed in capital ratio [Computed above]	3,000	4,500	6,000	4,500
Interest on capital which was distributed in p.s.r. [₹18,000 in 4:3:2:1]	7,200	5,400	3,600	1,800
	(–) 4,200	(–) 900	2,400	2,700

Illustration 9: ***Past adjustment – Omission of interest on capital – Rectification of wrong distribution of profit***

A and B are in partnership sharing profits on the following basis:

- Profits upto ₹20,000 will be drawn entirely by A.
- Profits above ₹20,000 and upto ₹60,000 will be shared in the proportion of 3:1.
- Profits above ₹60,000 will be shared equally.

The accounts for the year ended Dec. 31, 2017 showed a profit of ₹ 90,000 which was allocated and credited to the respective partners' accounts on the above basis. It was, however, found subsequently that B was not credited with a salary of ₹10,000 to which he was entitled and that interest at the agreed rate of 10% p.a. was not allowed on the partners' capitals. Their capitals on Jan. 1, 2017 were: A ₹1,00,000 and B ₹50,000.

Show by way of a single journal entry how the net amount refundable by one partner to another is to be recorded.

Solution

Books of .... (the firm)

Journal

Date	Particulars	Dr. ₹	Cr. ₹
31.12.17	A's Capital A/c Dr.	2,500	
	To B's Capital A/c		2,500
	(Being interest on capital and partners' salary omitted to record in the books, now rectified)		

WORKING NOTES

1. **Adjustment for redistribution of profit**

	A (₹)	B (₹)
Right distribution:		
Interest on capital [**A:** ₹1,00,000 × 10%, **B:** ₹50,000 × 10%]	10,000	5,000
Salary to B	—	10,000
Share of profit[1]**:** Upto ₹20,000 [distributed to A only]	20,000	—
Above ₹20,000 but upto ₹60,000 [3:1]	30,000	10,000
Above ₹60,000 [₹65,000 – ₹60,000]	2,500	2,500
(i)	62,500	27,500
Distribution already made:		
Share of profit: Upto ₹20,000 [distributed to A only]	20,000	—
Above ₹20,000 but upto ₹60,000 [3:1]	30,000	10,000
Above ₹60,000 [(₹90,000 – ₹60,000) in 1:1]	15,000	15,000
(ii)	62,500	25,000
∴ **Difference (i) – (ii)**	(–) 2,500	(+) 2,500

[1] **Divisible Profit:** ₹90,000 – ₹(10,000 + 5,000) – ₹10,000 = ₹65,000

Illustration 10: ***Past adjustments – Preparation of Partners' Capital A/c – Guarantee given by a partner to another partner***

The summarized Capital Accounts of the partners of M/s NNP & Sons. appear as under:

Dr. **Partners' Capital A/c** **Cr.**

Particulars	Nupur	Neha	Pallavi	Particulars	Nupur	Neha	Pallavi
31.12.17				1.1.17			
To Drawings A/c	12,000	12,000	12,000	By Balance b/f	20,000	30,000	40,000
To Balance c/f	23,000	33,000	43,000	By P/L Appropriation A/c	15,000	15,000	15,000
	35,000	45,000	55,000		35,000	45,000	55,000

On Jan. 1, 2018 it is agreed that the following would be effective retrospectively from Jan. 1, 2017:

(a) Nupur shall be entitled to a salary of ₹750 p.m.;

(b) Interest shall be allowed on Partners' Capitals at 10% on the opening balances;

(c) Profit shall be shared in proportion to opening balance in capital accounts; and

(d) Pallavi's share of profit inclusive of interest on capital shall not fall below ₹18,000, the deficit, if any, being contributed by Nupur out his share.

You are required to show entries in the Capital A/c on Jan. 1, 2018 by a single Journal entry to give effect to the above arrangement. **[*CA, Entrance – Adapted*]**

Solution

Books of M/s NNP & Sons.

Dr. **Partners' Capital A/c** **Cr.**

Particulars	Nupur	Neha	Pallavi	Particulars	Nupur	Neha	Pallavi
13.12.17				1.1.18			
To Pallavi's Capital A/c	—	3,000	—	By Balance b/f	23,000	33,000	43,000
To Balance c/f	23,000	30,000	46,000	By Neha's Capital A/c	—	—	3,000
	23,000	33,000	46,000		23,000	33,000	46,000

WORKING NOTES

1. Adjustment for redistribution of profit (Fig in ₹)

	Nupur	Neha	Pallavi
Right distribution:			
Salary to Nupur [₹750 × 12]	9,000	—	—
Interest on capital [Nupur: 20,000 × 10%, Neha: 30,000 × 10%, Pallavi: 40,000 × 10%]	2,000	3,000	4,000
Share of profit:			
Distribution of Divisible Profit [(₹15,000 × 3) – 9,000 – (2,000 + 3,000 + 4,000)] in 2: 3: 4	6,000	9,000	12,000
Pallavi's deficit borne by Nupur [18,000 – (4,000 + 12,000)]	(2,000)	—	2,000
(i)	15,000	12,000	18,000
Distribution already made:			
Share of profit **(ii)**	15,000	15,000	15,000
∴ **Difference (i)–(ii)**	—	(3,000)	3,000

Illustration 11: ***Past adjustments – Rectification of Divisible Profit – Correct determination of Net profit – Preparation of P/L Appropriation A/c and Partners' Capital A/c***

Accountancy and Management are two partners sharing profits and losses in the ratio 3:2. On Dec. 31, 2017 their Capital Accounts stood at ₹55,000 and ₹45,000 after distribution of net profit of ₹15,000 and due consideration of drawings of the partners for ₹6,000 and ₹4,000 respectively. After closing the books following discrepancies were discovered:

(a) An item in the inventory was valued at ₹12,800 but had a realisable value of ₹8,300.
(b) ₹2,400 paid for insurance premium for the year ending on Mar. 31, 2018 had been debited to P/L A/c.
(c) Interest on Capital at 5% on Partners' Capital as at the beginning of the year and interest on drawings of partners at 8% p.a. was left out of consideration.

Ascertain the correct Net Profit of the firm and redistribute the profit by preparing a P/L Appropriation A/c and determine the balance of Partners' Capital A/c. **[*C.U. B.Com. (Hons), 2002 – Dates changed*]**

Solution

Statement showing Correct Net Profit of the firm (fig in ₹)

Overvaluation of Closing Stock [1]	4,500
Less: Prepaid Insurance [2][₹2,400 × 3/12]	600
∴ ***Net decrease in profit for the year 2017***	3,900
Net profit as given	15,000
∴ ***Correct Net Profit of the firm for the year ended Dec. 31, 2017***	11,100

N.B.: [1] **Overvaluation of Closing Stock:** As per AS-2, Stock is to be valued at 'Cost or Net Realisable Value (NRV) - whichever is lower' principle. As NRV of stock is lower than its cost, Closing Stock was overvalued by ₹[₹12,800 – ₹8,300] ₹4,500. So, the inflated profit is to be reduced by ₹4,500.

[2] **Prepaid Insurance:** As the annual insurance paid for the year ended Mar. 31, 2018, insurance premium related to months from Jan. 2018 to Mar. 2018 is to be treated as Prepaid Insurance because it relates to the next accounting period. As the entire amount of insurance was debited to P/L A/c, the profit for the year was deflated. So, the prepaid insurance is to be deducted from overvalued amount of stock to arrive at 'Correct Net Profit'.

Books of .... (the firm)

Dr. **P/L Appropriation A/c for the year ended Dec. 31, 2017** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital			By P/L Adj. A/c [Corrected Net Profit]		11,100
Accountancy [52,000 (WN: 1) × 5%]	2,600		By Interest on Drawings:		
Management [43,000 (WN: 1) × 5%]	2,150	4,750	Accountancy [6,000 × 8% × 6/12]	240	
To Partners' Capital A/c [Divisible Profit]			Management [4,000 × 8% × 6/12]	160	400
Accountancy (3/5)	4,050				
Management (2/5)	2,700	6,750			
		11,500			11,500

Dr. **Partners' Capital A/c** **Cr.**

Particulars	Accountancy	Management	Particulars	Accountancy	Management
To P/L Adjustment A/c [Distributed profit written back: ₹15,000 in 3:2]	9,000	6,000	By Balance b/f	55,000	45,000
			By Interest on Capital A/c	2,600	2,150
To Int. on Drawings A/c	240	160	By P/L Appropriation A/c [Divisible Profit]	4,050	2,700
To Balance c/f	52,410	43,690			
	61,650	49,850		61,650	49,850

WORKING NOTES

1. Capital balance of the partners before distribution of wrong profit

Dr. **Partners' Capital A/c** **Cr.**

Particulars	Accountancy	Management	Particulars	Accountancy	Management
To Partners' Drawings A/c	6,000	4,000	By Balance b/f [B/Fig.]	52,000	43,000
To Balance c/f [given]	55,000	45,000	By P/L Appropriation A/c [Divisible Profit – 3:2]	9,000	6,000
	61,000	49,000		61,000	49,000

Illustration 12: ***Concept building problem – Guarantee given to the partner under different alternatives***

A, B are partners in a firm sharing profit and losses equally. They allow to admit C for 1/10th share into the partnership on Apr. 1, 2015 with an additional guarantee clause in the partnership deed. The Net Profit of the firm for the year ended Mar. 2016; Mar. 2017 and Mar. 2018 are ₹2,50,000; ₹4,00,000 and ₹2,00,000 (Loss) respectively.

Calculate the share of profit of the partners at the end of each financial year under the following independent situations:

(a) C's share should not drop below ₹30,000. Deficit if any should be borne by the firm.
(b) C's share should not drop below ₹30,000. Deficit if any should be borne by A.
(c) C's share should not drop below ₹30,000. Deficit if any should be borne by A and B.
(d) C's share should not drop below ₹30,000. Deficit if any should be borne by A and B in 3:2 ratio.

Solution

Situation (a)

		2015–16 (₹)	2016–17 (₹)	2017–18 (₹)
Profit as given	(i)	2,50,000	4,00,000	(2,00,000)
∴ Share of profit of C [Being higher of the two]				
I. 1/10th of profit		25,000	40,000	(20,000)
II. Minimum share		30,000	30,000	30,000
∴ Profit share of C	(ii)	30,000	40,000	30,000
∴ Profit available after considering C's share of profit	(i) – (ii)	2,20,000	3,60,000	(2,30,000)
∴ Share of A (1/2)		1,10,000	1,80,000	(1,15,000)
∴ Share of B (1/2)		1,10,000	1,80,000	(1,15,000)

Situation (b)

		2015–16 (₹)	2016–17 (₹)	2017–18 (₹)
Profit as given	(i)	2,50,000	4,00,000	(2,00,000)
Share of profit of C: as if there is no guarantee	(i) × 1/10 = (ii)	25,000	40,000	(20,000)
Remaining profit	(i) – (ii) = (iii)	2,25,000	3,60,000	(1,80,000)
Share of profit:				
C: Minimum guarantee	(iv)	30,000	30,000	30,000
∴ **Ultimate share of profit of C**	Higher of (ii) & (iv)	30,000	40,000	30,000
Deficit of C's share borne by A	(ii) – (iv) = (v)	5,000	—	50,000
A: as if there is no guarantee	(iii) × 1/2	1,12,500	1,80,000	(90,000)
Less: Share of C's deficit [as computed in (v)]		5,000	—	50,000
∴ **Ultimate share of profit of A**		1,07,500	1,80,000	(1,40,000)
B: as if there is no guarantee	(iii) × 1/2	1,12,500	1,80,000	(90,000)
∴ **Ultimate share of profit B**		1,12,500	1,80,000	(90,000)

Situation (c)

As the deficit of C's share is borne by the remaining partners, the treatment will be same as in situation (a).

Situation (d)

		2015–16 (₹)	2016–17 (₹)	2017–18 (₹)
Profit as given	(i)	2,50,000	4,00,000	(2,00,000)
Share of profit of C: as if there is no guarantee	(i) × 1/10 = (ii)	25,000	40,000	(20,000)
Remaining profit	(i) – (ii) = (iii)	2,25,000	3,60,000	(1,80,000)
Share of profit:				
C: Minimum guarantee	(iv)	30,000	30,000	30,000
∴ **Ultimate share of profit of C**	Higher of (ii) & (iv)	30,000	40,000	30,000
Deficit of C's share borne by A and B	(ii) – (iv) = (v)	5,000	—	50,000
A: as if there is no guarantee	(iii) × 1/2	1,12,500	1,80,000	(90,000)
Less: Share of C's deficit	(v) × 3/5	3,000	—	30,000
∴ **Ultimate share of profit of A**		1,09,500	1,80,000	(1,20,000)
B: as if there is no guarantee	(iii) × 1/2	1,12,500	1,80,000	(90,000)
Less: Share of C's deficit:	(v) × 2/5	2,000	—	20,000
∴ **Ultimate share of profit B**		1,10,500	1,80,000	(1,10,000)

Illustration 13: ***Guarantee given by firm***

A, B, and C are in partnership sharing profits and losses in the ratio of 2:2:1. C's share is, however, guaranteed by the firm at a fixed minimum of ₹1,00,000. The net profit for the year ended Mar. 31, 2018 is ₹4,50,000.

Show the profit and loss appropriation account indicating the amount finally due to each partner.

[*C.U. B.Com. (Gen.) – Adapted*]

Solution

Problem Note **Guarantee by firm for a partner:** In this case, a firm provides guarantee to a partner for a minimum share of profit. It is calculated as under:

Step1: Determine the amount due to the guaranteed partner ***(being higher of the following two)***

(a) Share of profit based on p.s.r.

(b) Minimum share of profit guaranteed by firm

Step 2: Deduct the share of profit [computed in Step 1] of Guaranteed Partner from the Divisible Profit and divide such balance profit among the other partners in their mutual p.s.r.

Books of .... (the firm)

Dr. **P/L Appropriation A/c for the year ended Mar. 31, 2018** **Cr.**

Particulars	₹	₹	Particulars	₹	₹
To Partners' Capital A/c [Divisible Profit]			By P/L A/c [Net Profit]		4,50,000
A [WN: 2]	1,75,000				
B [WN: 2]	1,75,000				
C [WN: 1]	1,00,000	4,50,000			
		4,50,000			4,50,000

WORKING NOTES

1. C's share of profit (being higher of the two)

- Based on share of profit [₹4,50,000 × 1/5] = ₹90,000 } ∴ Share of C = ₹1,00,000
- Minimum share of C = ₹1,00,000

2. Distribution of Divisible Profit

Profit as given = ₹4,50,000

∴ Profit of the firm after deducting C's share of profit = ₹4,50,000 – ₹1,00,000 = ₹3,50,000

∴ Share of profit of A = ₹3,50,000 × 2/4 = ₹1,75,000

∴ Share of profit of B = ₹3,50,000 × 2/4 = ₹1,75,000

Illustration 14: ***Guarantee given by firm –Profit based on the sliding scale***

A, B and C are partners of a firm having Capitals of ₹80,000, ₹40,000 and ₹30,000 respectively on Apr. 1, 2017. The partnership deed provides that:

(a) Interest on Capital to be allowed at 6% p.a.

(b) A to get salary at ₹1,000 p.m.

(c) C to get commission @ 5% on the distributable profit.

(d) Profits to be divided as: upto ₹36,000 as 4:3:2 and above ₹36,000 equally subject to a minimum of ₹30,000 (inclusive of all) to C.

The net profit of the firm for the year ended Mar. 31, 2018 amounted to ₹1,05,000.

Prepare the Profit & Loss Appropriation Account and the Capital Accounts of the partners.

Solution

Books of .... (the firm)

Dr. P/L Appropriation A/c for the year ended Mar. 31, 2018 Cr.

Particulars	₹	₹	Particulars	₹	₹
To Interest on Capital:			By P/L A/c [Net Profit]		1,05,000
A [80,000 × 6%]	4,800				
B [40,000 × 6%]	2,400				
C [30,000 × 6%]	1,800	9,000			
To Partners' Salary: A [1,000 × 12]		12,000			
To Partner's Commission: C [(1,05,000 – 9,000 – 12,000) × 5/105]		4,000			
To Partners' Capital A/c [Divisible Profit]					
A [WN: 3]	29,900				
B [WN: 3]	25,900				
C [WN: 2]	24,200	80,000			
		1,05,000			1,05,000

Dr. Partners' Capital A/c Cr.

	A (₹)	B (₹)	C (₹)		A (₹)	B (₹)	C (₹)
To Balance c/f	1,26,700	68,300	60,000	By Balance b/f	80,000	40,000	30,000
				By Interest on Capital A/c	4,800	2,400	1,800
				By Partner's Salary A/c	12,000	—	—
				By Partner's Commission A/c	—	—	4,000
				By P/L Appro. A/c [Div. Profit]	29,900	25,900	24,200
	1,26,700	68,300	60,000		1,26,700	68,300	60,000

WORKING NOTES

1. Minimum Share of profit of C

As per the agreement,

C's minimum share from the firm = Interest on capital + Partner's commission + Share of profit = ₹30,000

∴ Minimum share of profit = ₹30,000 – ₹1,800 – ₹4,000 = ₹24,200

2. Share of profit of C *(being higher of the following two)*

1. Minimum share of profit **(i)**	₹24,200
2. Based on Profit sharing ratio:	
▪ Upto ₹36,000: 2/9th of ₹36,000	₹8,000
▪ Above ₹36,000 :1/3 rd of [80,000 – 36,000]	₹14,667
∴ Total share of C based on profit sharing ratio **(ii)**	₹22,667
∴ C's share of profit [Higher of (i) and (ii)]	₹24,200

3. Distribution of Divisible Profit between A and B

	A (₹)	**B (₹)**
Profit upto ₹36,000: [(₹36,000 – C's share upto ₹36,000) in 4:3]	16,000	12,000
Profit above ₹36,000: [Total Divisible Profit – ₹36,000 – C's share in firm's profit exceeding ₹36,000] in 1:1 ratio = [80,000 – 36,000 – (24,200 – 8,000)] in 1:1 ratio	13,900	13,900
∴ Ultimate share of profit of A and B	29,900	25,900

Illustration 15: ***Personal guarantee by an existing partner for incoming partner***

X and Y are partners in a firm sharing profits & losses at 3:2. They decided to admit Z, an employee of that firm into their partnership giving him 1/10th of the net profit and nothing else. Before becoming a partner, Z was getting a salary of ₹1,000 p.m. together with a commission of 4% of the net profit after deducting such salary and commission.

The agreement provided that share of Z's profit as a partner in excess of the amount to which he would have been entitled if he was an employee should be borne by X. The net profit for the year ended Mar. 31, 2018 amounted to ₹2,20,000.

You are required to prepare P/L Appropriation A/c of the firm for the year ended Mar. 31, 2018.

[*C.U. B.Com. (Gen.), 2005 –Dates changed*]

Solution

Problem Note **Personal guarantee by an existing partner to the incoming partner:** In this case, an existing partner provides guarantee to another partner for a minimum share of profit. It is calculated as under:

Step1: Determine the amount due to the Guaranteed Partner based on the normal share of profit.

Step 2: Divide the balance of profit after deducting the share of profit of Guaranteed Partner [as computed in step 1] among the other partners.

Step 3: Determine the extra share of profit (if any) of the Guaranteed Partner [Minimum share of profit – Profit based on normal profit sharing ratio].

Step 4: Deduct such extra share of profit [computed in step 3] from the guaranteeing partner [who provides the guarantee].

Books of .... (the firm)

Dr. **P/L Appropriation A/c for the year ended Mar. 31, 2018** **Cr.**

Particulars		**₹**	**Particulars**	**₹**
To Partners' Capital A/c [Divisible Profit]			By P/L A/c [Net Profit]	2,20,000
X [WN: 2]	1,18,000			
Y [WN: 2]	80,000			
Z [WN: 1]	22,000	2,20,000		
		2,20,000		2,20,000

WORKING NOTES

1. Z's share of profit and amount borne by X

- **Amount due to Z as an employee:**

  Salary @ ₹1,000 p.m. = ₹12,000

Commission of 4% of the net profit after deducting such salary and commission = [₹2,20,000 – ₹12,000] X 4/104 = ₹8,000

∴ Total amount due to Z as an employee = ₹12,000 + ₹8,000 = ₹20,000

- **Amount due to Z as a partner:**
  1/10th of the net profit = ₹2,20,000 × 10% = ₹22,000
- **Amount borne by X for Z:**
  Amount due to Z as employee <u>*Less*</u> Amount due to Z as a partner = ₹22,000 – ₹20,000 = ₹2,000

2. Distribution of Divisible Profit

Profit as given = ₹2,20,000

∴ Profit of the firm after deducting Z's share as a manager = ₹2,20,000 – ₹20,000 = ₹2,00,000

X = Share of profit as partner – Amount borne for Z = [(₹2,00,000 × 3/5) – ₹2,000] = ₹1,18,000

Y = ₹2,00,000 × 2/5 = ₹80,000

Illustration 16: ***Cross guarantee – Preparation of P/L Appropriation A/c & Partners' Current A/c***

Two fellows of IIM's, Ashok, and Rahul run a management consultancy firm for last few years. On Jan. 1, 2017, they allow to admit Nitin and decided to share future profits and losses in the ratio of 3:2:1 subject to the following agreement:

(a) Nitin's share of profit is guaranteed to be not less than ₹30,000 p.a.

(b) Nitin gives guarantee to effect that gross fees earned by him for the firm shall not be less than the average gross fees earned by him during preceding four years when he was carrying his own profession alone. The fees earned by him in last four years are ₹40,000, ₹46,000, ₹59,000 and ₹55,000. The profit for the firm for the year ended Dec. 31, 2017 was ₹ 1,50,000 and gross fees earned by Nitin was ₹32,000.

Show P/L Appropriation A/c.

Solution

Problem Note **Cross guarantee:** When a partner provides guarantee to the firm for a minimum share of profit for a particular accounting period and on the other hand, the firm assures a minimum share of profit to such partner from the firm, it is referred to as '*Cross guarantee*'. It is calculated and accounted for as under:

Step1: Ascertain the extra amount (if any) to be borne by the partner concerned.

[Income guaranteed by the partner – Income actually earned by him]

Journal entry:

Partners' Capital A/c Dr.
 To P/L Appropriation A/c

Step 2: Calculate the divisible profit of the firm [including the amount borne by the guaranteed partner].

Step 3: Ascertain the amount due to the concerned partner [to whom the guarantee was provided] as if there is no guarantee.

Step 4: If the minimum share of profit (guaranteed profit) is more than the share of profit of the concerned partner, then the guaranteed profit is to be allowed to the concerned partner, otherwise such partner will get normal share of profit based on profit sharing ratio.

Step 5: The balance profit [i.e. Divisible Profit – Share of profit of the concerned partner] is to be distributed among the remaining partners.

Books of .... (the firm)

Dr. P/L Appropriation A/c for the year ended Dec. 31, 2017 Cr.

Particulars		₹	Particulars	₹
To Partners' Capital A/c [Div. Profit – WN: 2]			By P/L A/c [Net Profit]	1,50,000
Ashok	82,800		By Nitin's Capital A/c [WN:1]	18,000
Rahul	55,200			
Nitin	30,000	1,68,000		
		1,68,000		1,68,000

WORKING NOTES

1. **Average fees earned by Nitin in preceding four years and his deficit from the guaranteed gross fees earned by him:**

   = ₹(40,000 + 46,000 + 59,000 + 55,000)/4 = ₹50,000

   ∴ Deficit in fees guaranteed by Nitin = Average gross fees earned by Nitin – Actual gross fees earned by him = ₹50,000 – ₹32,000 = ₹18,000

2. **Distribution of Divisible Profit**

   Firm's profit = Net Profit earned by the firm + Amount borne by Nitin = ₹1,50,000 + ₹18,000 = ₹1,68,000

   ∴ Nitin's share = ₹1,68,000 × 1/6 = ₹28,000

   As per the agreement Nitin is entitled to get a guaranteed profit of ₹30,000.

   ∴ Balance profit after considering Nitin's share = ₹1,68,000 – ₹30,000 = ₹1,38,000

   It is to be shared by Ashok and Rahul in 3:2 ratio.

   ∴ Ashok's share = ₹1,38,000 × 3/5 = ₹82,800; Rahul's share = ₹1,38,000 × 2/5 = ₹55,200

Illustration 17: ***Change in the basis of accounting with retrospective effect – Passing of single journal entry***

X and Y formed partnership sharing profits as 2:1. The term was to distribute mercantile profit. But cash profit has been calculated all through. Now it is desired to convert cash account into mercantile accounts. The details are:

	Profit as per cash basis	Closing outstanding Incomes	Closing outstanding Expenses
1st Year	₹10,000	₹1,000	₹ 500
2nd Year	₹12,000	₹3,000	₹1,000
3rd Year	₹18,000	₹2,000	₹ 800

Pass conversion entry. **[*ICWA (Stages I), June 1998*]**

Solution

Problem Note **Change in 'Basis of Accounting':**

- In this problem, the entity wants to change the basis of accounting from 'Cash Basis' to 'Accrual Basis'. It requires incorporation of 'outstanding income' and 'outstanding expenses' in the books of accounts.
- It is to be noted that outstanding income and outstanding expenses of 1st and 2nd year are not to be considered because they will have a nullifying effect on the total profit.

Books of .... (the firm)

Journal **Dr.** **Cr.**

Date	Particulars	₹	₹
	Outstanding Income A/c Dr.	2,000	
	To Outstanding Expenses A/c		800
	To X's Capital A/c		800
	To Y's Capital A/c		400
	(Being basis of accounting converted from cash basis to accrual basis and excess profit transferred to capital accounts)		

WORKING NOTES

1. **Profit under accrual basis for 3 years and distribution of profit among partners**

	₹
Profit as per Cash Basis for 3 years [10,000 + 12,000 + 18,000]	40,000
Add: Outstanding Income of 3rd year	2,000
	42,000
Less: Outstanding Expenses of 3rd year	800
∴ Profit under Accrual Basis	41,200

∴ Excess profit under accrual basis over cash basis = ₹41,200 – ₹40,000 = ₹1,200
∴ Extra profit share of X = ₹1,200 × 2/3 = ₹800
∴ Extra profit share of Y = ₹1,200 × 1/3 = ₹400

Alternatively,

Increase in Net income of 3rd year due to change in method of accounting from 'Cash basis' to 'Accrual basis'
= Outstanding Income of 3rd year – Outstanding Expenses of 3rd year = ₹2,000 – ₹800 = ₹1,200
∴ Extra profit share of X = ₹1,200 × 2/3 = ₹800; Extra profit share of Y = ₹1,200 × 1/3 = ₹400

Illustration 18: ***Change in the basis of accounting with retrospective effect – Passing of single journal entry***
Anand and Bharat are in partnership sharing profits and losses in the ratio of 3:2. With effect from Jan. 1, 2015 they decided to share the profits, earned in any year on the following basis:

Up to ₹50,000: Equally

Excess over ₹50,000: Anand: 2/3rd; Bharat: 1/3rd

They also decided to ascertain the income on mercantile basis with effect from the accounting year 2015. Although profits were shared on the basis of the new agreement, these were ascertained on cash basis only. It was agreed to make the necessary adjustments at the end of 2017. The relevant information is given below:

	2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
Profits already shared		42,000	46,000	62,000
As on Dec. 31:				
Accrued Income	4,000	7,000	10,000	5,000
Outstanding Expenses	1,000	2,000	2,600	600

You are required to give the necessary entries to correct the partners' accounts showing your workings assuming that books of accounts were duly closed at the end of each year. **[*ICWA Final (Adapted)*]**

Solution

Problem Note

- **Relevant adjustment for change in the basis of accounting**
  In this problem, the entity decided to ascertain the income on Mercantile Basis with effect from the accounting year 2015. For this purpose, profit of 2014 should also to be converted as it will affect the opening capital balance of the partners for the year 2015. However, excess or deficit in profit for the year 2014 will be shared in old profit sharing ratio (3:2) not in revised profit sharing ratio as the firm decided to change the basis of accounting since Jan. 1, 2015.
- **Recognition of Accrued Incomes and Outstanding Expenses:**
  As the entity decided to change the basis of accounting from 'Cash' to 'Accrual', 'Accrued Incomes' and 'Outstanding Expenses' are to be incorporated in the books of accounts.
  It is to be noted that only the 'Accrued Incomes' and 'Outstanding Expenses' of 2017 are to be incorporated. Accrued incomes and Outstanding Expenses of the preceding accounting periods (2014, 2015 and 2016) are not to be considered as they will have a nullifying effect on the total profit.

Books of .... (the firm)
Journal

Date	Particulars	Dr. ₹	Cr. ₹
31.12.17	Accrued Income A/c Dr.	5,000	
	To Outstanding Expenses A/c		600
	To Anand's Capital A/c [WN: 2]		2,000
	To Bharat's Capital A/c [WN: 2]		2,400
	(Being basis of accounting converted from cash basis to accrual basis and excess profit transferred to Partners' Capital A/c)		

WORKING NOTES

1. Profit under accrual basis

		2014 (₹)	2015 (₹)	2016 (₹)	2017 (₹)
Profits as per cash basis	**[A]**	—	42,000	46,000	62,000
Add: Accrued Income on Dec. 31 (Closing)		4,000	7,000	10,000	5,000
Outstanding Expenses on Jan. 1 (Opening)			1,000	2,000	2,600
		4,000	50,000	58,000	69,600
Less: Accrued Income on Jan. 1 (Opening)			4,000	7,000	10,000
Outstanding Expenses on Jan. 1 (Closing)		1,000	2,000	2,600	600
∴ Profit as per accrual basis	**[B]**	3,000	44,000	48,400	59,000
∴ Excess/(Deficit) Profit	**[A – B]**	3,000	2,000	2,400	(3,000)

2. Sharing of excess/(deficit) profit (Fig in ₹)

Year	Excess/(Deficit) ₹	PSR	Anand	Bharat	Remarks
2014	3,000	3:2	1,800	1,200	As basis of accounting converted since 2015, the excess profit adjusted in old ratio
2015	2,000	1:1	1,000	1,000	As total profit [WN:1] less than ₹50,000
2016	2,400	1:1	1,200	1,200	As total profit [WN:1] less than ₹50,000
2017	(3,000)	2:1	(2,000)	(1,000)	As total profit [WN:1] more than ₹50,000
	∴ Net effect		2,000	2,400	

Illustration 19: ***Admission of manager as a manager with retrospective effect – Passing of single Journal entry for rectification***

Kalyani and Ranu commenced business on July 1, 2015 as partners with Capitals of ₹1,80,000 and ₹1,20,000 respectively. The Capitals remain fixed and carry interest @ 10% p.a. Profits & Losses are to be shared in proportion to their Capitals.

They appointed Anita as their manager on July 1, 2015 at a salary of ₹9,600 p.a. plus a bonus of 5% of the profits after charging such bonus and interest on capital. Anita had to deposit on July 1, 2015 ₹80,000 as security carrying interest at 12% p.a.

In June 2017 it was settled that Anita should be treated as partner from the commencement of the business. It was agreed that she would be entitled to one-fifth of the profits and her security deposit would be treated as her Capital carrying interest @ 10% p.a. instead of the 12% she had received. It was further agreed that this new arrangement should not result in Anita's share for any of these years being less than she had already received under the original agreement and terms of her appointment.

The profits before charging Anita's bonus and interest on Capital of partners on giving effect to the new arrangements were:

(a) For the year 2015–16: ₹60,000, (b) For the year 2016–17: ₹1,20,000 (c) For the year 2017–18: ₹1,60,000

Show by a single journal entry to give effect to the new arrangements with explanatory computation.

[*C.U. B.Com. (Hons), 1996 – Dates changed*]

Solution

Problem Note

- **Steps to be followed for determining 'Extra' amount due to Anita and its treatment:**

  Step-I: Determine the amount due to Anita as a manager

  Step-II: Determine the amount due to Anita as a partner

  Step-III: Determine the 'Extra' amount due to Anita as a partner

  Step-IV: Determine the amount borne by the Existing partners [Kalyani and Ranu]

- **Maintenance of Capital:** As the firm maintains the partners' capital accounts under 'Fixed Capital Method', the rectification entry is to be passed involving Partners' Current Accounts.

Books of .... (the firm)
Journal

Date	Particulars		Dr. ₹	Cr. ₹
Jun. 2017	Kalyani's Current A/c	Dr.	9,362	
	Ranu's Current A/c	Dr.	6,242	
	To Anita's Current A/c			15,604
	(Being excess amount payable to Anita is borne by Kalyani and Ranu – WN: 5)			

WORKING NOTES

1. Interest on Capital of partners

- **Before considering Anita as a partner**
  Capital of Kalyani and Ranu = ₹1,80,000 + ₹1,20,000 = ₹3,00,000
  ∴ Interest on Capital of Kalyani and Ranu = 10% on ₹3,00,000 = ₹30,000
- **After considering Anita as a partner**
  Capital of Kalyani, Ranu and Anita = ₹1,80,000 + ₹1,20,000 + ₹80,000 = ₹3,80,000
  ∴ Interest on Capital of Kalyani and Anita = 10% on ₹3,80,000 = ₹38,000

2. Amount due to Anita as a Manager

	2015–16	2016–17	2017–18
Salary [Given]	9,600	9,600	9,600
Interest on Security Deposit [₹80,000 × 12%]	9,600	9,600	9,600
Bonus: [5% of Net Profit after charging Bonus and Interest on Capital]			
2015–16 [₹60,000 – ₹30,000 (WN:1)] × 5/105	1,429		
2016–17 [₹1,20,000 – ₹30,000 (WN:1)] × 5/105		4,286	
2017–18 [₹1,60,000 – ₹30,000 (WN:1)] × 5/105			6190
∴ Amount due to Anita as Manager	20,629	23,486	25,390

3. Revised Divisible Profit if Anita is considered as Capital and her share of profit

	2015–16	2016–17	2017–18
Net Profit as given in the problem	60,000	1,20,000	1,60,000
Add: Anita's salary [not payable if she is considered as partner]	9,600	9,600	9,600
Int. on Anita's security dep. [not payable if she is considered as partner]	9,600	9,600	9,600
Profit before interest on Capital to the partners	79,200	1,39,200	1,79,200
Less: Interest on Capital [WN:1]	38,000	38,000	38,000
∴ Divisible Profit for the year	41,200	1,01,200	1,41,200
∴ Anita's share of profits [Divisible Profit × 1/5]	8,240	20,240	28,240

4. Amount due to Anita as a Partner

	2015–16	2016–17	2017–18
Interest on Capital [₹80,000 × 10%]	8,000	8,000	8,000
Share of profit [WN: 3]	8,240	20,240	28,240
∴ Amount due to Anita as partner	16,240	28,240	36,240

5. Extra amount due to Anita as Partner as compared to Manager

	2015–16	2016–17	2017–18
Amount due to Anita as partner [WN: 4]	16,240	28,240	36,240
Less: Amt. due to Anita as manager [WN: 2]	20,629	23,486	25,390
∴ Extra Amt. due to Anita	—	4,754	10,850

N.B.: In the year 2015–16, the amount due to Anita as manager is more than the amount due to her as a partner. So, according to the agreement no adjustment is needed for such extra amount which was allowed to her.

∴ Total extra amount due to Anita as a partner = ₹4,754 + ₹10,850 = ₹15,604

It is to be borne by Kalyani and Ranu in their profit sharing ratio [their Capital ratio] because it was excess credited to their account in such ratio.

∴ Amt. borne by Kalyani = ₹15,604 × 3/5 = ₹9,362; ∴ Amt. borne by Ranu = ₹15,604 × 2/5 = ₹6,242

EXERCISES

1. A, B and C started a partnership firm on 1.4.2017. A introduced ₹10,000 on 1.4.2017 and further introduced ₹4,000 on 1.10.2017. B introduced ₹5,000 at first on 1.4.2017 but withdrew ₹5,000 from the business on 31.12.2017. C introduced ₹5,000 at the beginning on 1.4.2017, increased it by ₹5,000 on 1.7.2017 and reduced it to ₹10,000 on 1.2.2018.
During the year 2017-2018 they made a net profit of ₹75,500. The partners decided to provide interest on their capitals at 10% p.a. and to divide the balance of profit in their effective capital contribution ratio.
Prepare the Profit and Loss Appropriation Account for the year ended 31.3.2018.
[*ICWA (Inter) - June-2013 – Dates Changed*]
[***Ans.*** Share of Profit: A- ₹15,948; B – ₹31,568; C – ₹22,704]

2. A and B are Partners sharing profits in the ratio of 5:3. Following is the Balance Sheet of the Firm on 31.3.2017 (Fig. in ₹):

Liability	**₹**	**Assets**	**₹**
Capital:		Drawings:	
A	80,000	A	5,000
B	20,000	B	3,000
		Other Assets	92,000
	1,00,000		1,00,000

Profit for the year 2013–14 was ₹16,000 and was divided between the Partners as per agreed ratio, but interest on capital at 5% p.a. and on drawings @ 6% was inadvertently omitted. Interest on drawing may be calculated on an average basis for 6 months.
You are required to pass Journal Entry to make the adjustments in the Capital accounts of A and B.
[*ICWA (Inter) – Dec.-2011 – Dates Changed*]

3. P and Q are partners sharing profits and losses in the ratio of 5:4. On Apr. 1, 2017 they admitted their Manager R into partnership for $^1/_5{}^{th}$ of the share of the profits. As Manager, R was receiving a salary of ₹60,000 per year and a commission of 5 percent on the net profit after charging such salary and commission. It is, however, agreed that any excess over his former remuneration to which R becomes entitled as a partner is to be borne by Q.
The profits of the firm for the year ended Mar. 31, 2018 amounted to ₹4,27,500. You are required to show the division of profits among the partners.
[*ICWA (Inter) 2011 – June – Dates Changed*]
[***Ans.*** Share of Profit: P – ₹1,94,444; Q – ₹1,47,556, R – ₹85,500]

4. Ashok and Bala who where in partnership sharing 7:5 respectively, admitted Chand as a partner giving him 1/5^{lh} share from 1.4.2017. The new profit sharing ratio is 7:5:3. Chand brought ₹96,000 towards goodwill to be shared by Ashok and Bala in their sacrificing ratio. The amount so brought was however credited to Chand's capital account by mistake.
The Trial Balance of the firm as on Mar. 31, 2018 is given below:

	Dr. (₹)	**Cr. (₹)**
Ashok's capital		3,36,000
Bala's capital		2,40,000
Chand's capital		2,24,000
Sundry Creditrs		48,000
Current year profit		2,20,000
Other Assets	7,70,000	
Ashok's drawing	1,45,600	
Bala's drawing	1,04,000	
Chand's drawing	20,400	
Cash in hand	28,000	
	10,68,000	10,68,000

Interest on drawings is to be ignored but interest on capital is to be charged at 5% per annum which was not made so far. Prepare new Balance Sheet as at 31.3.2018 giving effect to above adjustments/omissions.

[*ICWA (Inter) – Dec. 2012 – Dates Changed*]

[***Ans.*** Sacrificing Ratio 7:5**,** Correct balance of Partners' Capital Ashok – ₹3,5,0,000; Bala - ₹2,50,000; Chand – ₹1,50,000, Balance Sheet total ₹7,98,000]

5. Good, Better and Best are in partnership sharing profits and losses in the ratio 3:2:4. Their capital account balances as on Mar. 31, 2018 are as follows:
   Good: ₹1,70,000 (Cr); Better: ₹1,10,000 (Cr); Best: ₹1,22,000 (Cr)
   Following further information provided:
   1. ₹22,240 is to be transferred to General Reserve.
   2. Good, Better and Best are paid monthly salary in cash amounting to ₹2,400, ₹1,600 and ₹1,800 respectively.
   3. Partners are allowed interest on their closing capital balance @ 6% p.a. and are charged interest on drawings @ 8% p.a.
   4. Good and Best are entitled to commission @ 8% and 10% respectively of the net profit before making any appropriation.
   5. Better is entitled to commission @ 15% of the net profit before charging Interest on Drawings but after making all other appropriations.
   6. During the year Good withdrew ₹2,000 at the beginning of every month, Better ₹1,750 at the end of every month and Best ₹1,250 at the middle of every month.
   7. Firm's Accountant is entitled to a salary of ₹2,000 per month and a commission of 12% of net profit after charging such commission.

   The Net Profit of the firm for the year ended on Mar. 31, 2018 before providing for any of the above adjustments was ₹2,76,000.
   You are required to prepare Profit and Loss Appropriation Account for the year ended on Mar. 31, 2018.

   [*CA IPCC - Nov – 2012 – Dates Changed*]

   [Divisible Profit Good: ₹20,223; Better: ₹13,482; Best: ₹26,964]

6. A and B are partners in a firm sharing profits and losses in 3:2 ratio. Their capital accounts as on Dec. 31, 2017 showed balances of ₹35,000 and ₹30,000 respectively. The drawings of A and B during the year 2017 were ₹20,000 (on Jun. 30, 2017) and ₹10,000 (on Jan. 1, 2017) respectively. After taking into account the profits of the year 2017 which amounted to ₹20,000, it was subsequently found that the following items have been left out while preparing the final accounts of the year ended 2017.
   The partners were entitled interest on capitals @ 10% p.a.
   - The interest on drawings was also to be charged @ 5% p.a.
   - A was entitled to a remuneration of ₹5,000 and B was entitled to a commission of 1% on sales. The sales for the entire year comes to ₹1,00,000.
     It was decided to make the necessary adjustments to record the above omissions.

   a. Prepare journal (if adjustment are made through P/L Adjustment A/c), P/L Adjustment A/c and Partners' Capital Accounts,
   b. Give single adjustment entry if adjustments are made through capital accounts.

7. X and Y were partners with ₹10,000 as capital contributed equally. They shared profits as follows: Salary to X ₹1,000 p.a.; Salary to Y ₹500 p.a.; Remaining Profits as 1:1.
   Due to certain circumstances, it became necessary to make the following changes in the shares of X and Y: Salary to X ₹250 p.a.; Salary to Y ₹500 p.a.: Remaining Profits as 1:1.
   The above new change was applicable subject to Z being introduced on Jan. 1, 2017 as a partner (without capital) at a salary of ₹750 and one-seventh share in the profit and loss of the firm (after charging interest on capital and salaries) all of which was to be charged to X with the exception of ₹800, the amount of salary Z had formerly received as manager of the firm. X and Y are entitled to interest on capital at 5% p.a. The profit for the year ended Dec. 31, 2017 before charging interest on capital or partners' salary was ₹2,770.
   Prepare the P/L Appropriation A/c. **[*ICWA Inter (Adapted)*]**

8. P, Q and the latter's daughter R were partners in the firm. On Apr. 1, 2017 S, the clerk, was admitted as a partner. It was decided to share profits and losses among P, Q, R and S as 4:3:2:1 and in addition R is also entitled to salary of ₹1,200 p.a.

S had previously been paid a salary of ₹2,000 per annum and a commission of 3% of the profits, after charging his salary and commission but before charging any partner's salary. It was agreed that for the first year of the new partnership, any excess of his share of profit over the sum he would have earned had he remained as clerk increased by ₹1,400, should be charged to P's share of profits.

On considering the draft accounts of the year ended Mar. 31, 2018, the partners agreed to the following adjustments:

(a) To provide for a staff bonus of ₹11,000;

(b) That P's son T, the manager of the business, should receive an additional bonus of ₹500 chargeable against his father's share of profit;

(c) That ₹1,000 of Q's share of profits should be credited to his daughter R.

The profits for the year ended Mar. 31, 2018, before making the above adjustments and before charging S's Salary, amounted to ₹64,000.

You are required to prepare P/L Appropriation A/c for the year ended Mar. 31, 2018. **[*CS Final (Adapted)*]**

9. X, Y and Z are partners in a firm of solicitors since Jan. 1, 2015. They maintain accounts on cash basis and share profits and losses in 5:3:2 ratio after allowing salary to partners - X ₹16,000 p.a., Y ₹10,000 p.a. and Z ₹4,000 p.a. Z's share is guaranteed to a fixed minimum of ₹10,000 including salary. In 2018, partners decided to change the method of accounting in 'mercantile basis' with retrospective effect. Relevant information is as follows:

Year	Profit on cash basis before charging Partners' salary	Outstanding expenses on Dec. 31	Fees earned but not received on Dec. 31
2015	₹48,000	₹12,000	₹10,000
2016	₹56,000	₹10,000	₹16,000
2017	₹80,000	₹6,000	₹10,000

Pass a single entry adjusting partners' accounts to give effect to above change.

READY ACCESS TO EXAMINATION PROBLEMS

C.U. B.Com.				Professional Courses (Year and Course)	
Year	Illustration No.	Year	Illustration No.	Year	Illustration No.
1994 (Hons)	7	2000 (Gen.)	6	ICWA Stage-I June. 1998	17
1996 (Hons)	19	2002 (Hons)	11		
1998 (Hons)	2	2005 (Gen.)	15		