Accounting for Partnership Firms:
<u>Basic Concepts</u>:

Meaning and Definition
According to Section 4 of the Partnership Act 1932 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all"
Features of partnership Firm
1) Association of two or more persons: There must be at least two persons and maximum of 50 persons to form a partnership and they must be competent to contract.
2) Partnership Agreement or Deed: There must be an agreement among partners to form a partnership. It can be written or oral.
3) Legal Business: The business of the partnership firm must be a legally allowed business.
4) Sharing of Profits or Losses: The partners must share profits or losses in a certain ratio.
5) Mutual Agency: The partners mutually take part in daily routine work or the work may be carried on by one or more partners on behalf of the other partners. Every partner is legally liable for the acts of all other partners, whether he is taking part in the activities of the firm or not.
6) Unlimited Liability: Partners' liability to the third parties is unlimited. If there are losses, and the firm is not able to pay its debts fully, then all the partners shall be jointly and severally liable to pay the debts of the firm to an unlimited extent.
Partnership Deed: The document, which contains terms of the agreement, is called' Partnership Deed'. It generally contains the details about all the aspects affecting the relationship between the partners including the objective of business, contribution of capital by each partner, ratio in which the profits and the losses will be shared by the partners and entitlement of partners to interest on capital, interest on loan, etc.
Provisions of Partnership Act, 1932 in the absence of Partnership Deed:
(a) Profit Sharing Ratio: If the partnership deed is silent about the profit sharing ratio, the profits and losses of the firm are to be shared equally by partners.
(b) Interest on Capital: No interest on capital is payable if the partnership deed is silent on the issue.
(c) Interest on Drawings: No interest is to be charged on the drawings made by the partners, if there is no mention in the Deed.
(d) Interest on Advances: If any partner has advanced some money to the firm beyond the amount of his capital for the purpose of business, he shall been titled to get an interest on the amount at the rate of 6 percent perannum.
(e) Remuneration for Firm's Work: No partner is entitled to get salary or other remuneration for taking part in the conduct of the business of the firm.
Fixed and Fluctuating Capital Accounts of Partners
There are two methods by which the capital accounts of partners can be maintained. These are:

(i) Fixed capital method and
(ii) fluctuating capital method.

<u>Fixed Capital Method:</u> Under the fixed capital method, the capitals of the partners shall remain

fixed unless additional capital is introduced or a part of the capital is withdrawn as per the agreement among the partners. All items like share of profit or loss, interest on capital, drawing interest on drawings, etc. are recorded in separate accounts, called Partner's Current Account.
* The partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital.
* The partners' current account on the other hand, may show a debit or a credit balance. Thus under this method, two accounts are maintained for each partner viz., capital account and current account, While the partners' capital accounts shall always appear on the liabilities side in the balance sheet, the partners' current account's balance sall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.
The partner's capital account and the current account under the fixed capital method would appear as shown below:

Partner’s capital account

Date	Particulars	Jf	Amount	Date	Particulars	Jf	Amount
	To Bank A/c(permanent withdrawal of capital) To Balance c/d (closing balance)		…… ……		By Balance b/d By Cash/Bank A/c (Additional Capital)		…… …….
			…..				……

Partner’s current account

Date	Particulars	Jf	Amount	Date	Particulars	Jf	Amount
	To Balance b/d (Incase of debit opening balance) To Drawings A/c (Drawings against Profit) To Interest on Drawings A/c To Profit and Loss A/c (Loss) To Balance c/d*		…… ……… …….. …….. ……….		By Balance b/d (In case of credit opening balance) By Interest on Capital A/c By Commission A/c By Partners ‘Salary A/c By Profit andLoss App. A/c(Profit)		……… ……… ……… ……… ……….
			………..				……….

Fluctuating Capital Method: Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc. are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. In the absence of any instruction, the capital account should be prepared by this method. The proforma of capital accounts prepared under the fluctuating capital method is given below:-

Partner’s capital account

Date	Particulars	Jf	Amount	Date	Particulars	Jf	Amount
	To Drawings To Bank (permanent withdrawal of capital) To Interest on Drawings A/c To Profit and Loss Appropriation A/c (Loss) To Balance c/d*		…….. ……... ………. …….. ………		By Balance b/d By Cash/Bank A/c (Additional Capital) By Interest on Capital A/c By Commission A/c By Partners ‘Salary A/c		……. …….. ……… ……. ……… ………

					By Profit and Loss Appropriation .A/c (Profit)		
			………..				………

Difference between Fixed capital method and Fluctuating capital method

Basis	Fixed capital method	Fluctuating capital method
Meaning	Capitals of the partner's remains fixed unless additional capital is introduced. or a part of the capital is withdrawn.	Capitals of partners fluctuates.
No. of Accounts	Two separate accounts are maintained for each partner: 1. Capital account 2. Current account	Only one account called capital account maintained i.e
Adjustments	All adjustments like share of profit or loss, interest on capital, drawings, etc. are recorded in a separate account which is called partner's current account	All adjustments are like share of profit or loss, interest on capital, drawings, etc. are recorded in capital account of the partner.
Debit/Credit balance	Capital account will always show credit balance	It can show either debit or credit balance

Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.
You know that in the case of sole partnership the profit or loss, ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and as certain the final figure of profit and loss to be distributed among the partners, in their profit sharing ratio.
The Proforma of Profit and Loss Appropriation Account is given as follows:

Dr. Profit and Loss Appropriation Account Cr.

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

*Note: Interest on partner's loan is to be treated as a charge against profits.

Journal Entries for preparation of partner's capital/current account and Profit and Loss Appropriation Account:
1. Transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account:
(a) If Profit and Loss Account shows a credit balance (net profit):
Profit and Loss A/c Dr.
To Profit and Loss Appropriation A/c
(b) If Profit and Loss Account shows a debit balance (net loss)
Profit and Loss Appropriation A/c Dr.

To Profit and Loss A/c
2. Interest on Capital:
(a) For Allowing interest on capital:
Interest on Capital A/c Dr.
To Partner's Capital/Current A/cs (individually)
(b) For transferring interest on capital to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Interest on Capital A/c
3. Interest on Drawings:
(a) For charging interest on drawings to partners' capital/current accounts:
Partners Capital/Current A/c's (individually) Dr.
To Interest on Drawings A/c
(b) For transferring interest on drawings to Profit and Loss Appropriation Account:
Interest on Drawings A/c Dr.
To Profit and Loss Appropriation A/c

4. Partner's Salary:
(a) For Allowing partner's salary to partner's capital/current account:
Salary to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) For transferring partner's salary to Profit and Loss Appropriation Account:
Profit and Loss Appropriation A/c Dr.
To Salary to Partner's A/c
5. Partner's Commission:
(a) For crediting commission allowed to a partner, to partner's capita/currentl account:
Commission to Partner A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) For transferring commission allowed to partners to Profit and Loss Appropriation Account.
Profit and Loss Appropriation A/c Dr.
To Commission to Partners Capital/Current A/c
6. Share of Profit or Loss after appropriations:
(a) If Profit:
Profit and Loss Appropriation A/c Dr.
To Partner's Capital/Current A/c's (individually)
(b) If Loss:
Partner's Capital/Current A/c (individually)
To Profit and Loss Appropriation A/c
Note: In case firm suffers a loss, no interest on capital, salary, remuneration is to be allowed to partners.

Interest on Capital
No interest is allowed on partners' capitals unless it is expressly agreed among the partners. When the Deed specifically provides for it, interest on capital is credited to the partners at the agreed rate with reference to the time period for which the capital remained in business during a financial year. Interest on capital is generally provided for in two situations: (i) when the partners contribute unequal amounts of capitals but share profits equally, and (ii) where the capital contribution is same but profit sharing is unequal.
Interest on capital is calculated with due allowance for any addition or withdrawal of capital during the accounting period.
For example,
Mohini, Rashmiand Navin entered into partnership, bringing in Rs. 3,00,000, Rs. 2,00,000 and Rs. 1,00,000 respectively into the business. They decided to share profits and losses equally and agreed that interest on capital will be provided to the partners @10 per cent per annum. There was no addition or withdrawal of capital by any partner during the year. The interest on capital works out to Rs. 30,000 (10% on 30,000) for Mohini, Rs. 20,000 (10% on 2,00,000) for Rashmi, and Rs. 10,000 (10% on 1,00,000) for Navin.
Take another case of Mansoor and Reshma who are partners in a firm and their capital accounts showed the balance of Rs. 2,00,000 and Rs. 1,50,000 respectively on April 1, 2016. Mansoor introduced additional capital of Rs. 1,00,000 on August 1, 2016 and Reshma brought in further capital of Rs. 1,50,000 on October 1, 2016. Interest is to be allowed @ 6% p.a. on the capitals. It shall be worked as follows:

For Mansoor
(2,00,000*6/100)+(1,00,000*6/100*8/12= Rs. 12,000 + Rs. 4,000 = Rs. 16,000
For Reshma
(1,50,000*6/100)+(1,50,000*6/100*6/12)= Rs. 9,000+Rs. 4,500= Rs. 13,500
When there are both addition and withdrawal of capital by the partners during a financial year, the interest on capital is calculated as follows:
(i) On the opening balance of the capital accounts of partners, interest is calculated for the whole year;
(ii) On the additional capital brought in by any partner during the year, interest is calculated from the date of introduction of additional capital to the last day of the financial year.
(iii) In case of withdrawal of capital, interest on capital will be calculated as:
On opening capital from the beginning of the year till date of capital withdrawn and then on the reduced capital for the remaining time period. Alternatively, it can be calculated with respect of amount remained in business for the relevant period.
Illustration 5
Saloni and Srishti are partners in a firm. Their capital accounts as on April 01. 2016 showed a balance of Rs. 2,00,000 and Rs. 3,00,000 respectively. On July 01, 2016, Saloni introduced additional capital of Rs. 50,000 and Srishti, Rs. 60,000. On October 01 Saloni withdrew Rs. 30,000, and on January 01, 2016 Srishti withdraw, Rs. 15,000 from their capitals. Interest is allowed @ 8% p.a. Calculate interest payable on capital to both the partners during the financial year 2016–2017.
Solution
Statement Showing Calculation of Interest on Capital :
For Saloni

	(Rs.)
Interest on Rs. 2,00,000 for 3 months. 2, 00, 000 *8/100* 3/12	= 4000
Add : Interest on Rs. 2,50,000 for 3 months .2,50,000* 8/100* 3/12	= 5,000
Add : Interest on Rs. 2,20,000 for 6 months .2, 20,000* 6/12* 8/100	= 8,800
	17,800

For Srishti

	(Rs.)
Interest on Rs. 3,00,000 for 3 months .3,00,000* 8/100* 3/12	=24,000
Add : Interest on Rs,60,000 for 6 months 60,000* 8/100* 9/12 =	3, 600
	27,600
Less: Interest on Rs. 15,000 for 3 months . 15,000*8/100*3/12 =	300
	27,300

Sometimes opening capitals of partners may not be given. In such a situation before calculation of interest on capital the opening capitals will have to be worked out with the help of partners' closing capitals by marking necessary adjustments for the additions and withdrawal of capital, drawings, share of profit or loss, if already shown in the capital accounts the partners.
Illustration 6
Josh and Krish are partners sharing profits and losses in the ratio of 3:1. Their capitals at the end of the financial year 2015-2016 were Rs. 1,50,000 and Rs. 75,000. During the year 2015-2016, Josh's drawings were Rs. 20,000 and the drawings of Krish were Rs. 5,000, which had been duly debited to partner's capital accounts. Profit before charging interest on capital for the year was Rs. 16,000. The same had also been debited in their profit sharing ratio. Krish had brought additional capital of Rs. 16,000 on October 1, 2015. Calculate interest on capital @ 12% p.a. for the year 2015-2016.

Solution
Statement Showing Calculation of Capital at the Beginning

Particulars	Josh Rs.	Krish Rs.
Capital at the end	1, 50,000	75,000
Add: Drawings during the year	20,000	5,000
	1, 70,000	80,000
Less: Share of profit (credited)	12,000	4,000
	1, 58,000	76,000
Less: Additional capital	—	16,000
Capital in the beginning	1,58,000	60,000

Interest on capital will be as 18,960 (12% of Rs. 1,58,000) for Josh and

Rs. 960 for krish calculated as follows:
(60,000*12/100) (16,000*12/100*6/12)
= Rs. 7,200 + Rs. 960
= Rs. 8,160.
As clarified earlier, the interest on capital is allowed only when the firm has earned profit during the accounting year. Hence, no interest will be allowed during the year the firm has incurred net loss and if in a year, the profit of the firm is less than the amount due to the partners as interest on capital, the payment of interest will be restricted to the amount of profits. In that case, the profit will be effectively distributed in the ratio of interest on capital of each partner.
Illustration 7
Anupam and Abhishek are partners sharing profits and losses in the ratio of 3 : 2. Their capital accounts showed balances of Rs. 1,50,000 and Rs. 2,00,000 respectively on Jan 01, 2017. Show the calculation of interest on capital for the year ending December 31, 2017 in each of the following alternatives:
(a) If the partnership deed is silent as to the payment of interest on capital and the profit for the year is Rs. 50,000;
(b) If partnership deed provides for interest on capital @ 8% p.a. and the firm incurred a loss of Rs. 10,000 during the year;
(c) If partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of Rs. 50,000 during the year;
(d) If the partnership deed provides for interest on capital @ 8% p.a. and the firm earned a profit of Rs. 14,000 during the year.
Solution
(a) In the absence of a specific provision in the Deed, no interest will be paid on the capital to the partners. The whole amount of profit will however be distributed among the partners in their profit sharing ratio.
(b) As the firm has incurred losses during the accounting year, no interest on capital will be allowed to any partner. The firm's loss will however be shared by the partners in their profit sharing ratio.
Rs. .
(c) Interest to Anupam @ 8% on Rs. 1,50,000 = 12,000
Interest to Abhishek @ 8% on Rs. 2,00,000 = 16,000
28,000
As the profit is sufficient to pay interest at agreed rate, the whole amount of interest on capital shall be allowed and the remaining profit amounting to Rs. 22,000 (Rs. 50,000 – Rs. 28,000) shall be shared by the partners in their profit sharing ratio.
(d) As the profit for the year is Rs. 14,000, which is less than the amount of interest on capital due to partners, i.e. Rs. 28,000 (Rs. 12,000 for Anupam and Rs. 16,000 for Abhishek), interest will be paid to the extent of available profit i.e., Rs. 14,000. Anupam and Abhishek will be credited with Rs. 6,000 and Rs. 8,000, respectively. Effectively this amounts to sharing the firm's profit in the ratio of interest on capital, i.e., 3:4.

Interest on Drawings
The partnership agreement may also provide for charging of interest on money withdrawn out of the firm by the partners for their personal use. As stated earlier, no interest is charged on the drawings if there is no express agreement among the partners about it. However if the partnership deed so provides for it, the interest is charged at an agreed rate, for the period for which drawings have been made. Remained outstanding from the partners during an accounting year. Charging interest on drawings discourages excessive amounts of drawings by the partners. The calculation of interest on drawings under different situations is shown as here under.
When Fixed Amounts was Withdrawn Every Month
Many a time, a fixed amount of money is withdrawn by the partners, at equal time interval, say each month or each quarter. While calculating the time period, attention must be paid to whether the fixed amount was withdrawn at the beginning (first day) of the month, middle of the month or at the end (last day) of the month. If withdrawn on the first day of every month, interest on total amount will be calculated for 6½ months; if withdrawn at the end at every month, it will be calculated for 5½ months, and if withdrawn during the middle of the month, it will be calculated for 6 months using the following formula:

Interest on drawings = Total amount withdrawn x Rate of interest/100 x average period x 1/12

Suppose, Aashish withdrew Rs. 10,000 per month from the firm for his personal use during the year ending March 31, 2017. The calculation of average period and the interest on drawings, in different situations would be as follows:

(a) When the amount is withdrawn at the beginning of each month:

Average Period = $\frac{\text{No. of months of 1 drawings + No. of month of last drawings}}{2}$

$\frac{12+1}{2}$

6.5 months.

2020-21

Interest on Drawings = $\frac{1,20,000 \times 8 \times 13 \times 1}{100 \times 2 \times 12}$

= Rs. 5,200.

(b) When the amount is withdrawn at the end of each month

Average Period = $\frac{\text{No. of months of 1 drawings + No. of months of last drawings}}{2}$

$= \frac{11+0}{2}$

= 5.5 months

Interest on Drawings = $\frac{1\ 20\ 000 \times 8 \times 11 \times 1}{100 \times 2 \times 12}$

= Rs. 4,400.

(c) When money is withdrawn in the middle of the month

When money is withdrawn in the middle of the month, nothing is added or deduced from the total period.

Average Period = $\frac{\text{No. of months of 1 drawings + No. of month of last drawings}}{2}$

$= \frac{11.5+0.5}{2}$

= 6 months

Interest on Drawings = $\frac{1\ 20\ 000 \times 8 \times 6 \times 1}{100 \times 12}$

= Rs. 4,800.

When Fixed Amount is withdrawn Quarterly

When fixed amount of money is withdrawn quarterly by partners, in such a situation, for the purpose of calculation of interest, the total period of time is ascertained depending on whether the money was withdrawn at the beginning or at the end of each quarter. If the amount is withdrawn at the beginning of each quarter, the interest is calculated on the total money withdrawn during the year, for a period of seven and half months i.e.,

$\frac{12+3}{2}$

= 7.5 months

and if withdrawn at the

and of each quarter it will be calculated for a period of 4½ months, i.e.,

$\frac{9+0}{2}$

Suppose Satish and Tilak are partners in a firm, sharing profits and losses equally. During financial year 2016–2017, Satish withdrew Rs. 30,000 quarterly. If interest is to be charged on drawings @ 8% per annum, the calculation of average period and interest on drawings will be as follows:

(a) If the amount is withdrawn at the beginning of each quarter

Statement Showing Calculation of Interest on Drawings

the interest can be calculated on the total amount withdrawn during the accounting year, i.e. Rs. 1,20,000 for a period of 7½ months (12+9+6+3)/4. as follows:

= $\frac{1,20,000 \times 8 \times 15 \times 1}{100 \times 2 \times 12}$

= 6,000.

(b) If the amount is withdrawn at the end of each quarter

Statement Showing Calculation of Interest on Drawings
Alternatively, the interest can be calculated on the total amount withdrawn during the accounting year, i.e., Rs. 1,20,000 for a period of 4½ months (9 + 6 + 3 + 0)/4 months as follows:

$$= \text{Rs. } \frac{1{,}20{,}000 \times 8 \times 9 \times 1}{100 \times 2 \times 12}$$

= Rs. 3,600

When Varying Amounts are Withdrawn at Different Intervals
When the partners withdraw different amounts of money at different time intervals, the interest is calculated using the product method. Under the product method, for each withdrawal, the money withdrawn is multiplied by the period (usually expressed in months) for which it remained withdrawn during the financial year. The period is calculated from the date of the withdrawal to the last day of the accounting year. The products so calculated are totaled and on the total of the products interest at the specified rate is calculated as under:
Total of products × Rate/100 ×1/12
For example,
Shahnaz withdrew the following amounts from her firm, for personal use during the year ending March 31, 2017. Calculate interest on drawings by product method, if the rate of interest to be charged is 7 per cent per annum.

Date	Amount (Rs.)
April 1, 2016	16,000
June 30, 2016	15,000
October 31, 2016	10,000
December 31, 2016	14,000
March 1, 2017	11,000

Calculation of interest on drawings will be as follows:
Statement Showing Calculation of Interest on Drawings

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

Interest = Sum of Products × Rate × 1/
12
= Rs. 4,30,000 ×7/100 ×1/12
= 30100/12
= Rs. 2,508 (approx.).
Illustration 8
John Ibrahm, a partner in Modern Tours and Travels withdrew money during the year ending March 31, 2017 from his capital account, for his personal use. Calculate interest in drawings in each of the following alternative situations, if rate of interest is 9 per cent per annum.
(a) If he withdrew Rs. 3,000 per month at the beginning of the month.
(b) If an amount of Rs. 3,000 per month was withdrawn by him at the end of each month.
(c) If the amounts withdrawn were : Rs. 12,000 on June 01, 2016, Rs. 8,000; on August 31, 2016, Rs. 3,000; on September 30, 2016, Rs. 7,000, on November 30, 2016, and Rs. 6,000 on January 31, 2017.
Solution
(a) As a fixed amount of Rs. 3,000 per month is withdrawn at the beginning of the month, interest on drawings will be calculated for an average period of 61/2 months.

$$\text{Interest on drawings} = \text{Rs. } \frac{36{,}000 \times 9 \times 13 \times 1}{100 \times 2 \times 12}$$

= Rs. 1,755
(b) As the fixed amount of Rs. 3,000 per month is withdrawn at the end of each month, interest on drawings will be calculated for an average period of 51/2 months.

$$= \frac{36{,}000 \times 9 \times 11 \times 1}{100 \times 2 \times 12}$$

= Rs. 1,485

(C) Statements showing Calculation of Interest on Drawings

Date	Amount Withdrawn(Rs.)	Period (in months)	Product (Rs.)
Jun. 1, 2016	12,000	10	1, 20, 000
Aug. 31, 2016	8,000	7	56,000
Sept. 30, 2016	3,000	6	18,000
Nov. 30, 2016	7,000	4	28,000
Jan. 31, 2017	6,000	2	12,000
			2 , 34,000

Total Interest = 2, 34,000*9/100*1/12

= 1,755

Illustration 9

Manu, Harry and Ali are partners in a firm sharing profits and losses equally. Harry and Ali withdrew the following amounts from the firm, for their personal use during 2019-2020.

Date	Harry (Rs.)	Ali (Rs.)
2019		
April, 01	5,000	7,000
July, 01	8,000	4,000
December, 01	5,000	5,000
March, 01, 2020	4,000	10,000

Calculate interest on drawings if the rate of interest to be charged is 10 per cent, and the books are closed on December 31 every year.

Statement Showing Calculation of Interest on Drawings

Harry			Ali		
Amount (Rs.)	Period (in months)	Product (Rs.)	Amount (Rs.)	Period (in months)	Product (Rs.)
5000	12	60,000	7,000	12	84,000
8000	9	72,000	4,000	9	36,000
5000	4	20,000	5,000	4	20,000
4000	1	4,000	10,000	1	10,000
		1, 56,000			1, 50,000

Amount of Interest

Harry = $\frac{1,56,000 \times 10 \times 1}{100 \times 12}$

= Rs. 1,300

Ali = $\frac{1,50,000 \times 10 \times 1}{100 \times 12}$

= Rs. 1,250

Problems for practice:

1. Govind is a partner in a firm. He withdrew the following amounts during the year 2015-16:

	(Rs.)
April 30, 2019	6,000
June 30, 2019	4,000
Sept. 30, 2019	8,000
Dec. 31, 2019	3,000
Jan. 31, 2020	5,000

The interest on drawings is to be charged @ 6% p.a. The books are closed on March 31, every year. Calculate interest on drawing :

2. Ram and Syam are partners sharing profits/losses equally. Ram withdrew Rs. 1,000 p.m. regularly on the first day of every month during the year 2018-19 for personal expenses. If interest on drawings is charged @ 5% p.a. Calculate interest on the drawings of Ram.

3. Verma and Kaul are partners in a firm. The partnership agreement provides that interest on drawings should be charged @ 6% p.a. Verma withdraws Rs. 2,000 per month starting from April 01, 2019 to March 31, 2020. Kaul withdrew Rs, 3,000 per quarter, starting from April 01, 2019. Calculate interest on partner's drawings.

When Dates of Withdrawal are not specified

When the total amount withdrawn is given but the dates of withdrawals are not specified, it is assumed that the amount was withdrawn evenly throughout the year.

For example;

Shakila withdrew Rs. 60,000 from partnership firm during the year ending March 31, 2020 and the interest on drawings is to be charged at the rate of 8 per cent per annum. For calculation of interest, the period would be taken as six months, which is the average period assuming, that amount is withdrawn evenly in the middle of the month, throughout the year. The amount of interest on drawings works out to be Rs. 2,400 as follows:

$$\frac{8 \times 6 \times 60{,}000}{100 \times 12}$$

= Rs. 2,400

Past Adjustments

If after closing the accounts for the year it is the discovered that some errors have been committed, then these errors have to be rectified. Some adjustment entries have to be passed to rectify the error. The entries are made through Profit & Adjustment A/c. These entries are to rectify the errors committed in past, therefore, they are known as 'Past Adjustments'. Generally the following types of errors are committed:

(i) Interest on Capital and on Drawings have been omitted.

(ii) Interest on Capital and on Drawings have been provided at higher or lower rates than the rates agreed in the Deed.

(iii) Salary or commission to partners either not given or a higher or lower amount has been given.

(iv) Profit shared in a wrong ratio.

Adjustment Chart

Particulars	A	B	C	Firm
Interest on capital	+	+	+	-
Partner's salary/commission	+	+	+	-
Interest on drawings	-	-	-	+
	+	+	+	
For taking back wrong profit	-	-	-	+
Profit after all adjustments	+	-	+	0

* Assumed that there are three partners A, B and C.
* Assumed that all errors are related to omission
* + means Cr the partner's capital A/c
* - means Dr the partner's capital A/c
* In last+ amount should be equal to- amount

Note: Similarly following errors can be rectified accordingly:

(i) Interest on Capital and on Drawings have been provided at higher or lower rates than the Rates agreed in the Deed

(ii) Salary or commission to partners either a higher or lower amount has been given.

Guarantee of Profit to a Partner

Guarantee of profit means a minimum amount of profit to be paid to a partner. This amount shall be given to him if his share of profit is lower than the guaranteed amount. The deficit shall be borne either by one of the old partners or by all the old partners in a particular agreed ratio. If there is no agreement, then in their old profit sharing ratio, if his actual share of profit is more than the guaranteed amount, then, he will be given his actual share of profit. He gets the guaranteed amount or the actual share of profit, whichever is higher.

(a) Guarantee given by all partners

(i) Compare the amount of guarantee and his actual share of profit. If guaranteed amount is more than his actual share of profit, then the guaranteed amount will be debited to profit and loss Appropriation Account and the partner's account will be credited with the guaranteed amount.

(ii) The deficiency shall be shared by other partners in their profit sharing ratio.

(b) Guarantee given by One Partner only

First calculate his share of profit. Compare it with the guaranteed amount. The amount of deficiency is to be charged from the partner who gave guarantee.

(c) Guarantee given to a partner by other partners in a ratio different from their profit sharing ratio
Distribute profit among all the partners in the profit sharing ratio. Work out the amount of deficiency by comparing it with the guaranteed amount and his actual share of profit. The other partners will bear the deficiency in an agreed new ratio.

Goodwill

Meaning of Goodwill

Over a period of time, a well - established business develops an advantage of good name, reputation and wide business connections. This helps the business to earn more profits as compared to a newly setup business. In accounting, the monetary value of such advantage is known as "goodwill".
Factors Affecting the Value of Goodwill
The main factors affecting the value of goodwill are as follows:
1. Nature of business: A firm that produces high value added products or having as table demand disable to earn more profits and therefore has more goodwill.
2. Location: If the business is centrally located or is at a place having heavy customer traffic, the goodwill tends to be high.
3. Efficiency of management: A well-managed concern usually enjoys the advantage of high productivity and cost efficiency. This leads to higher profits and so the value of good will also be high.
4. Market situation: The monopoly condition or limited competition enables the concerned to earn high profits which leads to higher value of goodwill.
5. Special advantages: The firm that enjoys special advantages like import licenses, low rate and assured supply of electricity, long-term contracts for supply of materials, well-known collaborators, patents, trademarks etc. enjoy higher value of goodwill.
Need for Valuation of Goodwill
In a partnership firm, goodwill needs to be valued in the following circumstances:
1. Change in the profit sharing ratio amongst the existing partners;
2. Admission of new partner;
3. Retirement of a partner;
4. Death of a partner; and
5. Dissolution of a firm involving sale of business as a going concern.
6. Amalgamation of partnership firm
Methods of Valuation of Goodwill
1. Average Profits Method
(a) Simple Average
Stepwise procedure to calculate Goodwill under this method:
Step1: Work out profits or losses given for each of the past year after taking into account abnormalities, if any.
Step2: Calculate average by dividing the total profit of all the years by the number of years.
Step3: Goodwill= Average Profit x Number of year's purchase.
(b) Weighted Average
This is a better method than the simple average method. It takes into account the importance of each year. Under this method, earlier years are less important than the recent years. Thus, each year's profit is multiplied by its respective number (weight) in chronological order. The latest year will be given the highest weight and the earliest year will be given lowest weight. Each profit figure will be multiplied by its weight and then the total of these products will be calculated. This total will be divided by the total of weights.
Then Goodwill = Weighted average x number of years' purchase
2. Super Profit Method
Stepwise procedure to calculate Goodwill under this method:
Calculate the average profit,
1. Calculate the normal profit on the capital employed on the basis of the normal rate of return, Formula = Normal Profit = Capital Employed x NRR /100
2. Calculate the super profits by deducting normal profit from the average profits,
Formula- Super Profit = Average Profit - Normal Profit
3. Goodwill = Super profits x number of years 'purchase.
3. Capitalisation Method
Under this method the goodwill can be calculated in two ways: (a) by capitalizing the average profits, or (b) by capitalizing the super profits.

(a) Capitalisation of Average Profits: This involves the following steps:
(i) As certain the average profits based on the past few years' performance.
(ii) Capitalize the average profits on the basis of the normal rate of return to ascertain the capitalised value of average profits as follows:
Average Profits x 100/Normal rate of Return
(iii) As certain the actual capital employed (net assets) by deducting outside liabilities from the total assets (excluding goodwill).
Capital Employed/Net Assets = Total Assets (excluding goodwill) – Outside Liabilities
(iv) Compute the value of goodwill by deducting net assets from the capitalised value of average profits, i.e.(ii)–(iii).
Capitalisation of Super Profits: It involves the following steps.
(i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities. (i) Calculate capital employed of the firm, which is equal to total assets minus outside liabilities.
(ii) Calculate normal profit = Capital Employed X Normal Rate of Return/100
(iii) Calculate average profit for past years, as specified.
(iv) Super profits = average profits/Actual profit - normal profits
(v) Goodwill = Super Profits × 100/ Normal Rate of Return
Note: In other words, goodwill is the capitalised value of super profits. The amount of goodwill worked out by this method will be exactly the same as calculated by capitalising the average profits.

Question
X,Y and Z share profit in the ratio of 2:3:5.They earned a profit of Rs. 1,50,000 for the year ended 31-12-2015. The profit was by mistake distributed among X, Y and Z in the ratio of 3:2:1, respectively. This error was noted in the beginning of the new year. They have set up an old age Home for the old and poor in the city. Identify the business values and give the missing figures in the following solution

Particulars	X	Y	Z	Firm
1. Profit distributed in wrong ratio taken back Dr.	(75000)	(50000)	(25000)	150000
2. The profit now distributed in correct ratio Cr.	30000	45000	75000	(150000)
3. Adjusted profit	(45000)	(5000)	50000	0

Note: The amount put in the brackets means negative value.

And give adjustment entry.
X's Capital A/c Dr.45000
Y's Capital A/c Dr. 5000
To Z's Capital A/c 50000
(Being Adjustment entry made)
Value: Sensitivity towards poor. Fulfilling social responsibility