**1st June, 2020 JESUS AND MARY SCHOOL AND COLLEGE Module – 3**

**Class – 12**

**Subject – Accounts**

**Accounting for Partnership Firms – Fundamentals**

* Interest on loan given by the partner to the firm and rent paid to a partner :-
* Meaning : Both interest paid on partners loan and rent paid to a partner are charge against profit and not an appropriation of profit so they should be debited to profit and loss account and not to profit and loss appropriation account . If there is not agreement as to the rate of interest on loan, the partner is entitled to receive interest on loan @ 6% per annum.
* Accounting treatment : The entries will be made as follows :-

#### Interest on partner’s loan will be recorded as follows:

1. To provide interest on partner’s loan :

Interest on partner’s loan A/c Dr.

 To Partner’s loan A/c

1. To close interest on partner’s loan A/c :

Profit and loss A/c Dr.

 To Interest on partner’s loan A/c

**Note: - Interest on partner’s loan account should be credited to a separate partner’s loan account and not to partner’s capital A/c or partner’s current A/c.**

1. Rent paid to partner will be recorded as follows :
2. To provide rent to partner :

Rent A/c Dr.

 To Partner’s capital A/C / current A/C

1. To close rent A/c :

 Profit and loss A/c Dr.

 To Rent A/c

 **Note: Rent paid to a partner is to be credited to partner’s current account in case of fixed Capital system or to partner’s capital account in case of fluctuating capital system.**

* Interest on loan taken by a partner from the firm :-
* Meaning: Interest can be charged on loan taken by a partner from the firm at a specified rate with reference to time period, if partners are agreed. It is a gain to the firm.
* Accounting Treatment: Interest on loan taken by a partner from the firm should be credited to profit and loss account and debited to his capital / current A/C. The following entries are passed for it :
1. For charging interest on loan to a partner :

 Partner’s capital / Current A/c Dr.

 To Interest on partner’s loan A/c

1. For closing the interest on partner’s loan A/c :

 Interest on partner’s loan A/c Dr.

 To Profit and loss A/c

* When appropriations are more than profit :
* Meaning : In case where appropriations such as interest on capital, salary of partner etc. are more than available profits, the profits will be distributed in the ratio of appropriations (in the ratio of interest on capital and salary etc.) and not in profit sharing ratio. In other words, interest on capital or salary etc. will be restricted to the amount of profit and divisible profit will nil or zero.

If interest on capital is a charge, it will be provided weather firm has earned profit or not.

* Questions and their Solutions ( based on method discussed above )

Question 1 . A and B are partners sharing profit in the ratio of 3: 2. On 1st april, 2018 their capitals were Rs 5, 00,000 and Rs 3, 00,000 respectively. A was in need of funds and hence took a loan of Rs 1,00,000 from the firm on 1st July, 2018, agreed rate of interest being 12% p.a.

Profit for the year ended 31st march, 2019 amounted to Rs 1, 50,000 before charging interest on loan to A.

Pass journal entries for interest and prepare partner’s capital accounts.

Solution:

Journal of A and B

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Date | Particulars | L.F. | Dr. ( Rs ) | Cr. ( Rs ) |
| 2019March 31st  | A’s capital A/c Dr. To Interest on A’s loan A/c( Interest charged on loan to A for nine months @ 12 % p.a. ) |  | 9,0009,000 | 9,0009,000 |
| Interest on A’s loan A/c Dr. To Profit and loss A/C( Interest on loan transferred to Profit and Loss A/c ) |

Profit and Loss A/C

Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars | Rs |
| To Net profit transferred to profit and loss appropriation A/c | 1,59,000 | By Profit for year By Interest on A’s loan | 1,50,0009,000 |
| 1,59,000 | 1,59,000 |

Profit and Loss Appropriation A/C

Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars | Rs |
| To Net profit transferred to : A’s capital A/c 95,400 B’s capital A/c 63,600 | 1,59,000 | By Profit and Loss A/c  | 1,59,000 |
| 1,59,000 | 1,59,000 |

Partner’s Capital A/C

Dr . Cr.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | A | B | Particulars | A | B |
| To Interest A’s loan  A/c To Balance c/d | 9,0005,86,400 | 3,63,600 | By Balance b/dBy Profit and Loss  Appropriation  A/c | 5,00,00095,400 | 3,00,00063,600 |
| 5,95,400 | 3,63,600 | 5,95,400 | 3,63,600 |

QuestioN 2 . Rahim and Sudesh, the two partners of a business firm, agreed to appropriate the profits of their firm on the following terms:

1. Interest is payable on capital @ 5% per annum.
2. Rahim will be entitled to a salary of Rs 500 per month.
3. Loan advanced by a partner to the firm is to carry interest @ 10% per annum.
4. Interest on drawings to be charged from the partners @ 5% per annum.
5. Sudesh will get commission @ 1% on the sales made during the year.
6. Rahim is entitled to a rent of Rs 25,000 per annum for allowing the firm to carry on the business in his premises.

The net profit of the firm for the year ended 31st March, 2019, was Rs 1, 75,000 before taking into account any of the above terms.

|  |  |  |
| --- | --- | --- |
| Particulars | Rahim | Sudesh |
| Capital balances on 1st April, 2018Loan advanced to the firm on 1st October, 2018Drawings made during the yearLoan taken from the firm on 1st July, 2018 @ 12 % p.a. | 1,50,000-40,00050,000 | 1,40,0001,00,00030,000- |

During the year 2018-19, sales of the firm amounted to Rs 7, 00,000.

From the above information prepare:-

1. Profit and Loss appropriation account.
2. Partner’s Capital account

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Solution:

**Profit and Loss A/C**

**( For the year ended 31st March, 2019 )**

Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars | Rs |
| To Interest on sudesh’s  loan To Rent – RahimTo Profit transferred to  Profit and Loss  Appropriation A/c  | 5,00025,0001,50,000 | By Profit before interest By Interest on Rahim’s loan | 1,75,5004,500 |
| 1,80,000 | 1,80,000 |

**Profit and Loss appropriation A/C**

**For the year ended 31st March, 2019**

 Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars | Rs |
| To Interest on Capital : Rahim 7,500 Sudesh 7,000To Salary – RahimTo Commission – Sudesh ( 7,00,000 \* 1 % )To Profit transferred to : Rahim’s capital 62,125 Sudesh’s capital 62,125 | 14,5006,0007,0001,24,250 | By Profit and Loss A/c ( Net profit )By Interest on Drawings :  ( for six months ) Rahim 1,000 Sudesh 750 | 1,50,0001,750 |
| 1,51,750 |  | 1,51,750 |

**Partner’s Capital A/C**

 Dr Cr

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Particulars | Rahim  | Sudesh | Particulars | Rahim | Sudesh |
| To DrawingsTo Interest on  DrawingsTo Interest on  Rahim’s loanTo Balance c/d | 40,0001,0004,5002,05,125 | 30,000750-1,85,375 | By Balance b/dBy RentBy Interest on capitalBy SalaryBy CommissionBy Profit and Loss Appropriation A/c ( Profit ) | 1,50,00025,0007,5006,000-62,125 | 1,40,000-7,000-7,00062,125 |
| 2,50,625 | 2,16,125 | 2,50,625 | 2,16,125 |

**Note:-**

1. In the absence of information profit is divided equally.
2. In the absence of information about the date of drawing, interest on drawing has been calculated for six months.

Question3. A and B are partners sharing profits and losses in the ratio of 2 : 1 . A is a non- working partner and has contributed Rs 12, 00,000 as his capital. B is a working partner. The partnership deed provides for interest on capital @ 10 % p.a. and salary of Rs 7,500 per month to the working partner. The net profit for the year ended 31st March, 2016 before providing for interest on capital and salary amounted to Rs 70,000. You are required to show the distribution of profit.

**Solution:**

**Profit and Loss appropriation A/C**

 **( for the year ended 31st March,2016 )**

 Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars |  Rs |
| To Interest on A’s capital ( 4/7 of 70,000 )To Salary to B ( 3/7 of 70,000 ) | 40,00030,000 | By Profit and Loss A/c (net Profit ) | 70,000 |
| 70,000 | 70,000 |

 Working Note:-

 Interest on A’s capital = 12, 00,000 \* 10 % = 1,20,000

 Salary to B = 7,500 \* 12 = 90,000

 2,10,000

 Since available profit is only 70,000 which is less than appropriation of Rs 2, 10,000 . Hence profit will be distributed in the ratio of appropriations ( in the ratio of interest on capital and salary ) as under :

 Interest on capital : Salary

 Or 1,20,000 : 90,000

 Or 4 : 3

**Question4.** A and B are partners in a firm having capitals of Rs 60,000 and Rs 40,000 respectively. their profit sharing ratio is 4 : 1 . They agreed to charge interest on capital @ 10 % p.a. profit for the year before charging interest on capital amounts to Rs 8,000.

Prepare relevant account to allocate interest on capital of partners, when.

1. The partnership deed is silent about the treatment of interest on capital.
2. Interest is a charge as per partnership deed.

**Solution:**

1. When partnership deed is silent about the treatment of interest on capital.

**Profit and Loss appropriation A/c**

Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars | Rs |
| To Interest on capital : A 3/5 \* 8,000 B 2/5 \* 8,000To Divisible profit | 4,8003,200Nil | By Profit and Loss A/c ( Net profit ) | 8,000 |
| 8,000 | 8,000 |

Working Note –

Interest on A’s capital = 60,000 \* 10 % = 6,000

Interest on B’s capital = 40,000 \* 10 % = 4,000

 Total = 10,000

The available profit is Rs 8,000 whereas the interest due on capitals is Rs 10,000. Since the profit is less than interest, the available profit will be distributed in the ratio of interest i.e., 6,000: 4,000 or 3: 2.

1. When interest is a charge as per partnership deed :

**Profit and Loss A/c**

Dr. Cr.

|  |  |  |  |
| --- | --- | --- | --- |
| Particulars | Rs | Particulars | Rs |
| To Interest on Capital A/c : A 6,000 B 4,000 | 10,00010,000 | By Profit ( before interest )By Loss transferred to  Capital A/c : A 4/5 \* 2,000 = 1,600 B 1/5 \* 2,000 = 400 | 8,0002,00010,000 |

**WORK SHEET - 3**

**Do the following questions**

Question1. A, B and C are partners in a firm sharing profits and losses equally. On 1st April, 2018 their fixed capitals were Rs 8, 00,000, Rs 6, 00,000 and Rs 6, 00,000 respectively. On 1st october, 2018 A advanced Rs 1, 00,000 to the firm whereas C took a loan of Rs 1, 50,000 from the firm on the same date. It was agreed among the partners that C will pay interest @ 10 % p.a.

Profit for the year ended 31st March, 2019 amounted to Rs 4, 20,000 before allowing or charging interest on loans. Pass journal entries for interest on loans and prepare Current Accounts of the partners.

[ Ans. Divisible Profit Rs 4,24,500 ; Current A/c Balances : A Rs 1,41,500 (Cr.) ; B Rs 1,41,500 ( Cr.) and C Rs 1,34,000 ( Cr.)]

HINT: Interest on A’s loan will not be credited to his current A/c . It will be credited to his loan A/c.

Question2. P and Q are partners sharing profits and losses in the ratio of 3 : 2. On 1st April, 2017, their capitals were : P – Rs 5,00,000 and Q – Rs 3,00,000. During the year ended 31st March, 2018they earned a profit of Rs 7, 60,000. The terms of partnership are:

1. Interest on the capital is to be charged @ 8 % p.a.
2. P will get commission @ 3% on turnover.
3. Q will get a salary of Rs 5,000 per month.
4. Q will get commission of 5 % on profit after deduction of interest, salary and commission (including his own commission).
5. P is entitled to a rent of Rs 20,000 per month for the use of his premises’ by the firm.

Partner’s drawings for the year were: P – Rs 40,000 and Q – Rs30, 000. Turnover for the year was Rs 20, 00,000. After considering the above factors, you are required to prepare the profit and loss appropriation account and the capital accounts of the partners.

[Ans. Divisible profit Rs 3, 20,000. Balance of capital A/c : P Rs 9,92,000 and Q Rs 4,98,000.]

Question 3 . X and Y are partners in a firm sharing profits and losses in the ratio of 3 : 2 with capitals of Rs 10,00,000 and Rs 5,00,000 respectively. As per the partnership deed, they are to be allowed interest on capital @ 8 % p.a. The net profit for the year ended 31st March, 2016 before providing for interest on capital amounted to Rs 45,000. Show the distribution of profit.

 [Ans. Interest on capital allowed to X Rs 30,000 and Y Rs 15,000.]

Question4. P and Q are partners sharing profits or losses in the ratio of 3 : 2 . P is a non working partner contributed Rs 5, 00,000 as his capital. Q did not contribute any capital but agreed to act for firm. The partnership deed provided interest on capital @ 10 % p.a. and salary to working partner Rs 2,500 per month. The net profit before providing interest on capital and salary amounts to Rs 40,000 for the year ended 31st March, 2017. Show the distribution of profit for the year.

 [Ans. Interest on capital to P is allowed to Rs 25,000 and salary to Q is given Rs 15,000.]

Question 5. P and Q are partner in a firm sharing profits in the ratio 2 : 1 with capital of Rs 1,00,000 and Rs 80,000 respectively. Interest on capital is allowed @ 10 % p.a. profit for the year before charging interest on capital amounts to Rs 13,500. Prepare relevant accounts to allocate interest on capital of partners if:

1. Partnership deed is silent about treatment of interest on capital.
2. If interest is a charge as per partnership deed.

[Ans. Interest on capital; P Rs 7,500 and Q Rs 6,000, divisible profit nil,

 Net loss Rs 4,500]

 **Note:- Please do this work in your copies which will be checked when the school reopens .**

 **Please consider this important.**