ଓଡ଼ିଶା ରାଜ୍ୟ ମୁକ୍ତ ବିଶ୍ୱବିଦ୍ୟାଳୟ, ସମ୍ବଲପୁର, ଓଡ଼ିଶା
Odisha State Open University, Sambalpur, Odisha
Established by an Act of Government of Odisha.

Diploma in Accounting (DIA)

DIA-4
Financial Accounting

Block 1

Unit: I. Partnership: An Introduction

Unit: II. Appropriation of Profits

Unit: III. Admission of a Partner

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Course Writer

Dr. Rajesh Kumar Sain
HOD, IMBA Dept.
BJB (A) College
Bhubaneswar

Course Editor

Smt. Apekhya Sahay
Faculty, IMBA Dept,
BJB (A) College
Bhubaneswar

Material Production

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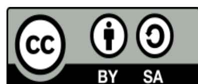
Odisha State Open University, Sambalpur



March, 2017
Odisha State Open University, Sambalpur

Unit -1: INTRODUCTION TO PARTNERSHIP

Learning objectives:

After studying this lesson, you will be able to know:

Meaning of partnership and features of partnership, objective of partnership, different types of partnership, essential elements of partnership, advantages and disadvantages of partnership, various types of partner and their power, right and duties. Partnership deed, meaning and procedure of registration.

Structure:

1.1 Introduction:

1.2 Meaning of partnership:

1.3 Features of Partnership

1.4 Objectives for partnership

1.5 Types of Partnership

1.6 Essential Elements of A Partnership

1.7 Advantages of Partnership

1.8 Disadvantages of partnership

1.9 Kinds of partnership

1.10 Partnership deed

1.11 Rights of partners

1.12 Powers of partners

1.13 Duties of partners

1.14 Partnership and Co partnership

1.15 Registration of Partnership

1.1 Introduction:

Partnership firm of business organization came into existence on account of limitations of proprietorship. The proprietorship form of ownership suffers from certain limitations such as limited resources, limited skill and unlimited liability. Expansion in business requires more capital and managerial skills, it also involves more risk. A proprietor finds him unable to fulfill these requirements. This call for more persons comes together, with different edges and starts business. When these persons come together, pool their capital and skills and organize a business, it is called partnership.

1.2 Meaning of partnership:

According to Kimbal, ``A group of men who have joined capital or services for the prosecuting of some enterprise.``

The Indian Partnership Act, 1932, Section 4, defined partnership as "the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all".

According to J. L. Hanson, "a partnership is a form of business organisation in which two or more persons up to a maximum of twenty join together to undertake some form of business activity".

So we can say Partnership as an association of two or more persons who have agreed to share the profits of a business which they run together. This business may be carried on by all or anyone of them acting for all.The persons who own the partnership business are individually called 'partners' and collectively they are called as 'firm' or 'partnership firm'. The name under which partnership business is carried on is called 'Firm Name'.

1.3 Features of Partnership:

Partnerships have certain default characteristics relating to both (a) the relationship between the individual partners and (b) the relationship between the partnership and the outside world. The former can generally be overridden by agreement between the partners, whereas the latter generally cannot be overridden this way. The features of partnership firms are described in brief as follows:-

(1) Agreement between the partners: Agreement is the base of partnership. Without agreement there cannot be partnership. The partnership comes into existence by an agreement or contract. The agreement may be oral or written.

(2) Profit sharing ratio: The main object of partnership is to make profit & to share these profits either equally or as per agreement. If agreement is silent then they share profit equally.

(3) Legal Business: partnership can be formed for the purpose of carrying on some legal business a partnership firm cannot perform charitable activities.

(4) Number of Partners: There must be at least two persons to start a partnership business. According to Indian Partnership Act, 1932, maximum numbers of partner should be for a partnership firm running 'Banking' business requires 10 members and in case of Non Banking business cannot have more than twenty members.

(5) Common Management: All partners of partnership can take active part in the management. It means partnership has common management. But practically it is not possible and convenient. Therefore it is managed by one or two partners on behalf of all other partners.

(6) Unlimited Liability: In India the liability of every partner is unlimited. All partners are collectively responsible for the payments of liabilities of the firm and even their personal property can be utilized for recovery of debts of the firm.

(7) Transfer of Interest : In partnership firm, the partners cannot transfer his interest to any other person or to any legal representative without the consent of other partners.

(8) Mutual Trust: It means the trust and confidence of partners in each other. Each partner has to work in the best interest of his firm. He must get full confidence & good faith of his partners. He must disclose all the information which is directly or indirectly related to the business.

(9) Dissolution: The partnership can be easily dissolved at any time if the partners agree to do so. It gets dissolved automatically, in case of death, insolvency or insanity of any of the partner. It gets dissolved if all the partners are declared insolvent or they resign from the partnership.

(10) Registration: The registration of partnership firm is not compulsory. The partners may register the firm with the registrar of firms of the state. However, in the state of Maharashtra, registration of partnership is compulsory.

1.4 Objectives for partnership:

Mission Alignment: To honor and respect the individual missions of each organization while investing in the complementary missions to create a shared future.

Shared Resources: To combine human and material resources where appropriate to enhance mission, support on-going programming, and initiate new programming. "Everyone brings something to the table".

Shared Relationships: To broaden visibility and value of each organization's programming and community presence through the extension of existing relationships and the development of new relationships.

Mutual Benefits: To expand and create opportunities that increase and improve the effectiveness of each organization with regard to mission attainment.

Leveraged Impact: To enhance program results through leveraged resources, combined resources, and the development of new resources.

Measurable Outcomes: To demonstrate effectiveness of programming toward mission attainment.

1.5 Types of Partnership

Different types of partnership: There are four relatively common partnership types:

1. General partnership (GP),
2. limited partnership (LP)
3. limited liability partnership (LLP).
4. Limited liability limited partnership (LLLP)

1. General (or Unlimited Partnership) : General partnerships are with the same features as discussed earlier, namely, limited liability, right to take part in management, optional registration, agency relationship, non transferability of interest,

restriction on the numbers, sharing of profits, etc. General partnership can be of the following three types:

Partnership at will: Its life is dependent on the will of the partners. It continues upto the time the partners enjoy trust and confidence of each other.

Fixed partnership: It exists for a fixed period of time only, say for 5 years. After the expiry of the fixed period, the partnership comes to an end.

Particular partnership: It is formed for the completion of a particular work, say construction of a bridge. It comes to an end after the completion of stipulated work.

2. Limited Liability Partnership (LLP): A Limited Liability Partnership enterprise, popularly known as LLP, is a world-wide recognized form of business organisation. It has now been introduced in India by enacting the Limited Liability Partnership Act, 2008. First LLP in India was formed in April 2009 and as many as 4679 LLPs have been registered in the country till May 2011. LLP is a new form of organisation that enables professional knowledge and entrepreneurial skill to combine, organize and operate in an innovative and proficient manner. It provides an alternative to the traditional partnership firm with unlimited liability.

The salient features of an Indian LLP include the following:

Status: An LLP is a body corporate and a legal entity separate from its partners. It is an artificial person being invisible, intangible having nobody, no mind and no soul and exists only in the eyes of law. Any two or more persons, associated for carrying on a lawful business with a view to earning profit, may be subscribing their nakes to an incorporation document and filing the same with the Registrar, form an LLP. An LLP has perpetual succession and any change in the composition of partnership of an LLP does not affect its existence.

Separate Legal Entity: LLP is a body corporate crated by law having a distinct name and perpetual succession. It has a legal entity separate from its partners. Its own rights and liabilities and distinct from those of its partners and any change in the partners does not affect its liabilities. Having the same capacity to enter into contracts as a private individual, an LLP is able to own all and any of the assets of the business which it is carrying on, ranging from intellectual property rights to freehold and leasehold land. There is also be no limitation on its legal capacity to borrow.

Number of Partners: An LLP must have at least two partners and also at least two individuals as Designated Partners, of whom at least one shall be resident in India. There is no maximum limit for the number of partners in an LLP. If at any time the number of partners of an LLP is reduced below two and the LLP carries on business

for more than six months while the number is so reduced, the person, who is the only partner of the LLP during the time that it so carries on business after those six months and has the knowledge of the fact that it is carrying on business with him alone, shall be liable personally for the obligations of the LLP incurred during that period.

Designated Partners: An LLP must have at least two Designated Partners who are individuals and at least one of them shall be a resident in India, provided that in case of an LLP in which all the partners are bodies corporate or in which one or more partners are individuals and bodies corporate, at least two individuals who are partners of such LLP or nominees of such bodies corporate shall act as Designated Partners.

Mandatory Electronic Identification Number for Designated Partners: Designated Partner Identification Number (DPIN) is mandatory for Designated Partners of LLPs. The allotment of DPIN for all existing and future Designated Partners of an LLP is mandatory. Only a single DPIN is required for an individual irrespective of number of partnerships held by him. Issuing DPIN in LLPs after verifying the credentials of Designated Partners will help the government to keep track of the people who run the LLPs. It shall help prevent a defaulting Designated Partner from hiding his past deeds and joining another LLP. This would also facilitate effective legal action against the Designated Partners of such LLPs under-the law, keeping in view the possibility of fraud by LLPs.

Limited Liability: Every partner of an LLP is, for the purpose of the business of theLLP, the agent of the LLP, but not of other partners. A partner is not personally liable, directly or indirectly for an obligation solely by reason of being a partner of the LLP. The provisions shall not affect the personal liability of a partner for his own wrongful act or omission, but a partner shall not be personally liable. for the wrongful act or omission of any other partner of the LLP. The liabilities of the LLP and partners who are found to have acted with the intent to defraud creditors or for any fraudulent purpose is unlimited for all or any of the debts or other liabilities of the LLP.

3. Limited partnership: A limited partnership is a business partnership where at least one owner is a general partner and at least one owner is a limited partner. The general partners make everyday business decisions and are personally liable for business debts. However, the limited partners simply invest in the business and have little control over business operations.

Features:

Limited partners do not play an active role in the business. The limited partners (most LPs have more than one limited partner) contribute financially to the business (for example, a limited partner might invest $100,000 in a real estate partnership) but have minimal control over business decisions or operations, and normally cannot bind the partnership to business deals.

Limited partners are not personally liable. In return for giving up management power, limited partners get the benefit of protection from personal liability. This means that a limited partner can't be forced to pay off business debts or claims with personal assets. A limited partner, however, can lose his or her financial investment in the business.

Limited partners face slightly different tax rules. For income tax purposes, limited partnerships generally are treated like general partnerships, with all partners individually reporting and paying taxes on their share of the profits each year. Limited partners, as a rule, do not have to pay self-employment taxes; because they are not active in the business, their share of partnership income is not considered "earned income" for purposes of the self-employment tax.

4. Limited liability limited partnership (LLLP): is a type of partnership that is very similar to a limited liability partnership (LP) in that it has two types of partners, general partners and limited partners. Unlike an LP, however, the general partners in an LLLP have some liability protection. The limited partners, however, still typically do not have any say in how the business is run.

Features : The main advantage of an LLLP is that all partners are protected by some form of liability protection, but limited partners still have typically have no say in how the business is run.

Despite offering liability protection for all members, business structures such as corporations and limited liability companies still offer more comprehensive protection.

1.6 Essential Elements of a Partnership:

1. Voluntary Agreement: The first element shows the voluntary contractual nature of partnership. A partnership can only arise as a result of an agreement, express or implied, between two or more persons. Where there is no agreement there is no partnership. But a partnership cannot be formed with more than ten persons in banking and twenty persons in other types of business.

2 Sharing of Profits of a Business: The second element states the motive underlying the information of a partnership. It also lays down that the existence of a business is essential to a partnership. Business includes any trade, occupation or profession. If two or more persons join together to form a music club it is not a partnership because there is not business in this case. But if two or more persons join together to give musical performances to the public with a view to earning profit, there is a business and a partnership is formed.

3. Mutual Agency: The third element is most important features of partnership. It states that persons carrying on business in partnership are agents as well as principals. The business of a firm is carried on by all or by any one or more of them on behalf of all. Every partner has the authority to act on behalf of all and can, by his actions, bind all the partner of the firm, each partner is the agent of the others in all matters connected with the business of the partnership.

1.7 Advantages of Partnership:

The following are the advantages of partnership business:

1. Easy formation: A partnership firm can be formed without any legal formalities and expenses. Even if the firm is to be registered, the expenses are not much compared to company form of organization.

2. More capital: A firm consists of more than one person. Therefore it can secure more capital from combined resources.

3. Skill and talent: Talented persons may be taken as partners. More skill and talent will be available..

4. Contact with customers: All the partners in a firm may take part in the management of the business. So, they get in touch with the customers during the course of the business. It enables them to study the tastes and needs of the customers.

5. Borrowing capacity: The creditors will lend Loans not only on the basis of the firm’s assets but also based on the personal properties of the partners. So the borrowing capacity of a firm is more.

6. Economy in operation: If there is co-operation among the partners the firm can be run efficiently. A good number of economies in management can be derived.

7. Division of risks: All losses and risks of the business are shared by all the partners. So risky ventures can also be taken up.

8. Maintenance of secrets: Business secrets can be maintained easily if the number of partners in a firm are limited.

1.8 Disadvantages of Partnership:

The following are the disadvantages of a partnership firm:

1. Delay in decisions: Sometimes the partners may not agree with one another in taking decisions. As a result partners will not be in a position to take quick decisions.

2. Lack of continuity: A partnership gets dissolved on the death, insolvency, insanity or retirement of any partner. So, there is no guarantee for the continuity of the firm.

3. Transferability of interest: In a firm the partner cannot transfer his share of interest to others without the consent of the other partners.

4. Lack of secrecy: It may not be possible to maintain secrecy in partnership because of the number of partners.

5. Unlimited liability: The creditors of a firm can recover their loan amounts from the personal properties of the partners when the firm's sources are not enough. Therefore the personal properties of the partners are not safe.

1.9 Kinds of partner:

There are various types of partners in a partnership firm. They are as follows:

1. Active partner: A person who takes active interest in the conduct and management of the business of the firm is known as active or managing partner. He carries on business on behalf of the other partners.

2. Sleeping partner: A sleeping partner is a partner who does not take active part in the management of the business. Such a partner only contributes to the share capital of the firm, is bound by the activities of other partners, and shares the profits and losses of the business.

3. Ostensible partner: A nominal partner is one who does not have any real interest in the business but lends his name to the firm, without any capital contributions, and doesn't share the profits of the business.

4. Partner by estoppels: If a person, by his words or conduct, holds out to another that he is a partner, he will be stopped from denying that he is not a partner. The person

who thus becomes liable to third parties to pay the debts of the firm is known as partner by estoppels.

5. Partner in profits only: When a partner agrees with the others that he would only share the profits of the firm and would not be liable for its losses, he is in own as partner in profits only.

6. Minor partner: at the time of creation of a firm a minor cannot be one of the parties to the contract. But under section 30 of the Indian Partnership Act, 1932, a minor 'can be admitted to the benefits of partnership', with the consent of all partners.

7. Secret partners: In partnership firms, several other types of partners are also found, namely, secret partner who does not want to disclose his relationship with the firm to the general public.

1.10 Partnership Deed:

The document containing the agreement between partners is called 'Partnership deed'. The document containing the agreement between the partners is called 'Partnership Deed'. The deed must be properly stamped and signed by all the partners except a minor who has to be admitted in the benefits of partnership.

It is better if the deed is very elaborate and clear about all possible questions which may rise in the course of partnership. In the absence of any agreement in relation to any point not incorporated therein, the provisions of the Partnership Act will apply and will determine their rights and duties.

Main Content of Partnership Deed:

Some of the important clauses to be included in a partnership deed are as follows:

(1) Name and permanent Address of the firm : The deed should contain name of the firm and place of its business.

(2) Name and Address of all Partners: The deed should also contain the names and address of all partners.

(3) Nature of Business: The nature of business proposed to be carried and its limitation should be included in it.

(4) Duration of Partnership: It the partnership is established for a fixed duration or for a fixed work, it should be stated in it.

(5) Partners' Capitals: The deed should contain the total amount of capital and contributions by each partner.

(6) Interest on Capital: If the partners decide to change interest on their capitals, the rate of interest should be mentioned in the deed.

(7) Drawing and Interest on it: The deed should contain the limit of drawings by every partner and the rate of interest to be charged.

(8) Share of Profit: Profit and loss sharing ratio should be stated in the deed. If it is not mentioned partners are authorized to share equally according to Partnership Act.

(9) Partners' Salary and Commission: If the partners decide to pay salary and commission to the partners, the deed should contain the amount of salary or commission payable to any partner for the services rendered to the business.

(10) Rights and Duties of Partners: If any partner has some special rights and duties regarding to conducts of business or if the liability of any partner is limited to the capital invested by him, these facts should also be mentioned in it.

(11) Admission and Retirement of Partners: After the establishment of partnership some new partners may be admitted and some may retire from the business. If any definite procedure is to be adopted at the time of admission or retirement of partner, it should be stated in it.

(12) Death of a Partner: The procedure of calculating the amount due to a deceased partner and the method of its payment to his successors should also be decided and stated in the deed.

(13) Valuation of Goodwill: The method of valuation of goodwill at the time of admission, retirement or death of a partner should be also being clearly stated in it.

(14) Revaluation of Assets and Liabilities: The method of revaluation of assets and liabilities on admission, retirement or death of a partner should also be clearly stated in it.

(15) Accounts and Audit: The procedure of keeping accounts and their audit should also be stated in it.

(16) Dissolution of Partnership: The deed should contain the firm and the method of the final settlement of accounts.

(17) Arbitration Clause: In case of disputes the method of appointing arbitrators and their rights should be clearly mentioned.

Impact of partnership deed: if there is any dispute among the partners, the partnership deed will serve as evidence in the court of law.

Rules to be followed in the absence of partnership deed:

1 sharing of profit and loss: The partners will share the firm`s profit and losses equally.

2 interests on partner's loan and advances: Partners are entitled to get interest on such loan and advances @ 6%p.a.

3 interests on capital: No interest will be allowed to partners on their capital contribution.

4 Salary and Commission: no partner is entitled to get any salary, commission, bonus for the services rendered by them.

5 interests on drawings: No interest will be charged on the drawings made by them.

1.11 Rights of partners:

Whatever properties contributed to the partnership by the general partners, or whatever the partnership has acquired throughout the operation of the business partnership, belong to the general partnership as a whole. The general partners have no right to individually own or use any specific asset of the partnership property. These are for the sole use of the partnership business only and not by individual partners.

1. Every partner has a right to take part in the conduct and management of the partnership firm.
2. Every partner is having a right to be consulted and heard in all the matters of business activation.
3. Every partner can inspect the books of account and take the copy if he wants so.
4. Every partner is having the right of sharing profits and losses equally in absence of any agreement.

5. Every partner has a right to receive interest at 6% per annum on the excess capital over the agreed share.

6. Every partner is entitled to be indemnified by the firm for all the acts done during the course of business activities.

7. Every partner is the joint-owner of the property for the partnership. He can use the property for the business of partnership.

8. Every partner can retire with the consent of other partners. He is also having the right to continue as a partner as per the agreement.

9. Every partner or the legal heirs of a deceased partner are entitled to share the profits of the business.

1.12 Powers of partners

A partner is considered as an agent of the firm. He can act on behalf of the firm. The third party can enforce against the firm for the acts of a partner. A partner is having unlimited liability and therefore he is fully responsible like along with the other partners for the debts of the firm. A partner of a trading firm can have the following powers on behalf of his firm:

1. Doing business activities in buying and selling goods.

2. Selecting right personnel for the firm.

3. Receiving or collecting dues and issuing receipts in the name of the partnership firms.

4. Drawing cheques on behalf of the firm. Drawing accepting and discounting Bills of Exchange and promissory notes on behalf of the firm.

5. Borrowing money for business activities on behalf of the firm.

1.13 Duties of partners:

A general partner has a fiduciary duty to the entire general partnership. This means that he or she has a legal duty to act solely in the interest of the organisation and of his or her partners. The general partner should use the partnership property to benefit everyone.

1. A partner who manages the business must keep the account of the partnership and should allow other partners to inspect and copy the same if they want.

2. A partner can act with in the scope of his authority as per the agreement

3. A partner should carry on the business keeping in mind the benefit of all the partner.

4. A partner is not entitled for salary unless agreed upon by all the partners.

5. A partner cannot do any business which is competitive with that of his firm.

6. A partner cannot use firm's property for his own needs.

1.14 Partnership and co-ownership:

Partnership is very much different from co-ownership. Ownership of a property by more than one person is called co-ownership, or joint ownership. In co-ownership, property is not put to business use. In partnership, there is a joint ownership of firm's property by the partners and it is used for business purposes. Thus, every partner is a co-owner of the property of the firm, but all co-owners of a property are not partners. Co-ownership of a property does not in itself constitute a partnership between the co-owners, whether they share any profits from it or not unless the property is put to a business use.

The difference between partnership and co-ownership can be put as follows:

Mode of creation. Partnership always arises from an agreement. But co-ownership may arise both by an agreement as well as by the operation of law of succession.

Objective. Partnership agreement is entered into to earn and distribute profits of the business. It involves community of interest, i.e., profit or loss. Co-ownership may not be concerned at all with the profits and losses. It may not involve the idea of working for profit.

Right of transfer of interest. A partner cannot transfer his share in the partnership to another person without the consent of all the partners. But a co-owner may transfer his interest to a stranger and break co-ownership at his will without the consent of other co- owners.

Mutual agency. Co-ownership is different from partnership in terms of agency relationship. In partnership, each partner is not only the principal but also the agent.

In case of co ownership is the owner is the owner of his share in the property. There is no mutual agency between co-owners, similar to that as between partners. Partners have the implied authority to act on behalf of the firm and bind other partners for his acts. But any co-owner cannot act as an agent for other co-owners

Right of lien for expenses. A co-owner cannot have any lien on the joint property for outlays or expenses or a common debt, but a partner can exercise this right on the property of the partnership firm, being an agent of other partners.

Partition of property. A co-owner has the right to demand partition of the property and get a part of the property as his share, or the property can be sold with the consent of other co-owners and obtain his share in the sale proceeds. But a partner cannot get the firm's property divided in its existing state. He can have the partnership property sold upon the dissolution of the firm and get the proceeds divided.

Specific law. Partnership is formed under the Partnership Act, 1932. No specific law exists for co-ownership. Co-ownership matters are decided by the general laws of the land.

1.15Registration of partnership:

Partnership firms in India are governed by the Indian Partnership Act, 1932. While it is not compulsory to register your partnership firm as there are no penalties for non-registration, it is advisable since the following rights are denied to an unregistered firm: A partner cannot file a suit in any court against the firm or other partners for the enforcement of any right arising from a contract or right conferred by the Partnership ActA right arising from a contract cannot be enforced in any Court by or on behalf of your firm against any third party Further, the firm or any of its partners cannot claim a set off (i.e. mutual adjustment of debts owned by the disputant parties to one another) or other proceedings in a dispute with a third party.

Registration Procedure: A partnership firm can be registered whether at the time of its formation or even subsequently. You need to file an application with the Registrar of Firms of the area in which your business is located. Application for partnership registration should include the following information:

– Name of your firm

– Name of the place where business is carried on

– Names of any other place where business is carried on

– Date of partners joining the firm

– Full name and permanent address of partners.

– Duration of the firm

Eligibility of partnership:

A partnership agreement can be entered into between persons who are competent to contract. Every person who is of the age of majority according to the law to which he is subject and who is of sound mind and is not disqualified from contracting by any law to which he is subject can enter into a partnership.

The following can enter into a partnership

1. Individual: An individual, who is competent to contract, can become a partner in the partnership firm. If there are more than two partners in a firm, an individual can be a partner in his individual capacity as well as in a representative capacity as Karta of the Hindu undivided family.

2. Firm: A partnership firm is not a person and therefore a firm can not enter into partnership with any firm or individual. But a partner of the partnership firm can enter into partnership with other persons and he can share the profits of the said firm with his other co-partners of the parent firm.

3. Hindu Undivided Family: A Karta of the Hindu undivided family can become a partner in a partnership in his individual capacity, provided the member has contributed his self acquired or personal skill and labor.

4. Company: A company is a juristic person and therefore can become a partner in a partnership firm, if it is authorized to do so by its objects.

5. Trustees: Trustees of private religious trust, family trust and trustees of Hindu mutts or other religious endowments are juristic persons and can therefore enter into partnership, unless their constitution or objects forbid.

Rights of a Minor:

1. A person who is a minor according to the law to which he is subject may not be a partner in a firm, but, with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

2. Such minor has a right to such share of the property and of the profits of the firm as may be agreed upon, and he may have access to and inspect and of the accounts of the firm.

3. Such minor - s share is liable for the acts of the firm, but the minor is not personally liable for any such act.

4. Such minor may not sue the partners for an account or payment of his share of the property or profits of the firm

5. At any time within six months of his attaining majority, or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, such person may give public notice that he has elected to become or that he has elected not to become a partner in the firm, and such notice shall determine his position as regards the firm, provided that, if he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

6. Where any person has been admitted as a minor to the benefits of partnership in a firm, the burden of proving the fact that such person had no knowledge of such admission until a particular date after the expiry of six months of his attaining majority shall lie on the person asserting that fact.

7. Where such person becomes a partner-

a. His rights and liabilities as a minor continue upto the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of the partnership, and

b. His share in the property and profits of the firm shall be the share to which he was entitled as a minor.

8. Where such person elects not to become a partner-

a. His rights and liabilities shall continue to be those of a minor upto the date on which he gives public notice,

b. His share shall not be liable for any acts of the firm done after the date of the notice, and

c. He shall be entitled to sue the partners for his share of the property and profits.

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Let's sum up:

Partnership as an association of two or more persons who have agreed to share the profits of a business which they run together. The persons who own the partnership business are individually called 'partners' and collectively they are called as 'firm' or 'partnership firm'. The name under which partnership business is carried on is called 'Firm Name'.in the absence of partnership deed, the partners will share the firm`s profit and losses equally. Partners are entitled to get interest loan and advances @ 6%p.a. No interest will be allowed to partners on their capital contribution and no partner is entitled to get any salary, commission, bonus for the services rendered by them.

Key terms:

Partnership: The relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all.

Limited partnership: A limited partnership is a business partnership where at least one owner is a general partner and at least one owner is a limited partner.

Active partner: A person who takes active interest in the conduct and management of the business of the firm is known as active or managing partner. He carries on business on behalf of the other partners.

Sleeping partner: A sleeping partner is a partner who does not take active part in the management of the business. Such a partner only contributes to the share capital of the firm, is bound by the activities of other partners, and shares the profits and losses of the business.

Ostensible partner: A nominal partner is one who does not have any real interest in the business but lends his name to the firm, without any capital contributions, and doesn't share the profits of the business.

Partner by estoppels: If a person, by his words or conduct, holds out to another that he is a partner, he will be stopped from denying that he is not a partner. The person who thus becomes liable to third parties to pay the debts of the firm is known as partner by estoppels.

Minor partner: at the time of creation of a firm a minor cannot be one of the parties to the contract. But under section 30 of the Indian Partnership Act, 1932, a minor 'can be admitted to the benefits of partnership', with the consent of all partners.

Secret partners: In partnership firms, several other types of partners are also found, namely, secret partner who does not want to disclose his relationship with the firm to the general public.

Partnership Deed: The document containing the agreement between the partners is called 'Partnership Deed'. The deed must be properly stamped and signed by all the partners except a minor who has to be admitted in the benefits of partnership.

Drawings: Assets in the form of Cash or Goods withdrawn from a business by the owner(s) for their personal use are termed as drawings

Partnership at will: Its life is dependent on the will of the partners. It continues up to the time the partners enjoy trust and confidence of each other.

Fixed partnership: It exists for a fixed period of time only, say for 5 years. After the expiry of the fixed period, the partnership comes to an end.

Particular partnership: It is formed for the completion of a particular work, say construction of a bridge. It comes to an end after the completion of stipulated work.

Co-ownership: Ownership of a property by more than one person is called co-ownership, or joint ownership. In co-ownership, property is not put to business use. In partnership, there is a joint ownership of firm's property by the partners and it is used for business purposes

Aggregate theory of partnership: partnership is only the totality of the partners who make it up. According to this theory, each partner is treated as the owner of a direct and undivided interest in partnership assets, liabilities and operations

Self-assessment Questions:

1. Describe the salient features of partnership deed.
2. What are the rights of a partner?
3. What are the powers of a partner?
4. What are the duties of a partner?
5. Discuss the objectives of partnership.
6. State the advantages and disadvantages of partnership.
7. Describe the different types of partner.

8. Describe the different types of partnership.

9. What do you mean by registration of partnership how is it done?

Model Questions:

1. What is partnership? State the chief characteristics of a partnership?

2. Describe the main provisions of the Partnership Act that are relevant to partnership accounts.

3. Define partnership, what are the essentials of partnership business?

4. What do you mean by partnership deed? What are the main clauses of partnership deed?

Further Readings:

1. Modern Accountancy: Hanif and Mukherjee, volume –I, Tata Mcgrawhill.

2. Higher secondary Accounting: Biswal and Sharma.

3. Financial Accounting: P.C. Tulsian, Pearson.

4. An Introduction to Accountancy: S.N. Maheshwari, S.K. Maheshwari. Vikas.

Unit –II: APPROPRIATION OF PROFITS

Learning objectives:

After studying this lesson, you will be able to know: what are profit& loss appropriation and uses of it. Difference between profit& loss and profit & loss appropriation account, difference between appropriation of profit and charge against profit.Consequences in the absence of partnership deed.Methods of preparing capital account, difference between capital and current account, difference between fixed and fluctuating capital, special items to be considered at the time of appropriation of profits.

Structure:

2.1 Introductions

2.2 P&L appropriation account

2.3 Difference between Difference between profit& loss account and profit& loss appropriation account.

2.4 Difference between Appropriation of Profit and Charge against Profit.

2.5 Rules to be followed for preparing appropriation account in the absence of partnership deed.

2.6 Capital accounts of the partners.

2.7 Following are some of the differences between Capital Account and Current Account.

2.8 Difference between fixed capital method and fluctuating capital method.

2.9 The Appropriation of profit.

2.10 Special items to be treated.

2.11Numericals.

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2.1 Introduction:

Appropriation Account is an additional accounting statement that is required for a partnership. For a sole trader, the profit for the year is simply transferred to the credit side of the proprietor's capital account. In the case of a partnership, profit will be credited to the profit and loss appropriation account, rather than the capital account. As each appropriation is dealt with, the double entry is completed through entries in both the appropriation account and the partner's current account (if current accounts are not maintained by the partnership, the entries will be made in the capital accounts).

2.2 Profit-and-Loss Appropriation account:

The profit-and-loss appropriation account is much different from the original profit-and-loss account. Once the first account has been created, the business must choose what to do with any extra earnings the business has created (as long as there is not a loss). Some money will be transferred into new investments and business growth accounts. Some will be used for bonuses. A portion of earnings will be distributed as dividends to the shareholders. The appropriation account shows what portion of earnings will be used for each of these activities.

Uses of Appropriation Account: The appropriation account is used within the business to tally earnings and match earnings to predetermined strategies for spending profit, but it has an important purpose outside the company as well. Investors can look at the appropriation account and see at a glance how much money the company is making and what kind of a dividend to expect, as well as how much of the company profit will be used for business growth, important factors when making an investment decision.

2.3 Difference between profit& loss account and profit& loss appropriation account:

1. Profit and loss account is a statement that shows the quantum of surplus funds available to the entity at the end of a financial period. Whereas profit and loss appropriation account gives you details about how the surplus that is shown in the profit and loss account is going to be spent.

2. Profit and loss account is a standalone statement and the profit and loss appropriation account is an extension of the former.

3. Profit and loss account is mandatory for all entities- partnerships, companies etc while the appropriation account is usually prepared only by partnership firms.

4. P&L appropriation account usually gives details about how the surplus money is going to be spent by each partner, how much is to be invested in capital expenditure, how much to be used as earmarked reserves etc. Profit and Loss Account shows how the profit/ loss is incurred, The items debited to this account are all expenses, i.e. a charge against profit, It is prepared in all kinds of firms.

5. Profit and Loss Appropriation Account shows how the net profit is appropriated, the items debited to this account are all appropriation of profit, and it is prepared in a partnership firm. Profit and loss contains the direct and indirect incomes, direct and indirect expenses. P&L Account shows the Gross profit and net profit achieved from the business during the year.

6. P&L appropriation account contains how the net profit has been used. P&L appropriation shows how the profits have been appropriated i.e., how the profits have been used.

7. Profit and loss account is made when there is loss or profit in the company .It is made after trading account. Whereas profit and loss appropriation is made when there is only profit in the company. It is an extension to profit and loss account.

8. Profit and loss account contains items which are charge against the profit. Whereas profit and loss appropriation account are appropriations of profit

9. Profit and loss account follows the matching principle (revenue =expenses), Where as in profit and loss appropriation account this principle is not followed.

2.4 Difference between Appropriation of Profit and Charge against Profit:

Appropriation of profit	Charge against profit
It is the distribution of net profit to various heads	It is the deduction from revenue to ascertain net profit or net loss
It is made only if there is a profit	It is made even if there is a loss
It is done after the creation of all the charges.	It is done before the appropriation of profit
This will be debited to P/L appropriation A/c.	It will be debited to P/LA/c

2.5 Rules to be followed for preparing appropriation account in the absence of partnership deed:

1 sharing of profit and loss: The partners will share the firm`s profit and losses equally.

2 interests on partner's loan and advances: Partners are entitled to get interest on such loan and advances @ 6%p.a.

3 interests on capital: No interest will be allowed to partners on their capital contribution.

4 Salary and Commission: no partner is entitled to get any salary, commission, bonus for the services rendered by them.

5 interests on drawings: no interest will be charged on the drawings made by them.

2.6 Capital accounts of the partners

Capital accounts of the partners can be maintained in two ways; partner's contribution to the partnership is called partners capital. It is not mandatory that each and every partner will contribute capital. It is also not mandatory every partner will contribute their capital in cash. it may be in the form of other assets. In partnership a separate account will opened for each partner. The account can be maintained in any of the following two ways.

1) Fixed Capital method

2) Fluctuating Capital method

1) Fixed Capital method:

Under this method the capital invested by the partners remains constant unless additional capital is brought in or some part of the existing capital is withdrawn permanently by agreement. Entry is made in the Capital accounts only to record the capital introduced or withdrawn permanently by the partners. All the other transactions relating to drawings, interest on capital or drawings, salary or commission to the partners, share of profit or loss etc are recorded in the newly opened Current Accounts.

Thus the two accounts are maintained in the books of the firm are:

1) Capital accounts

2) Current accounts

Dr Capital accounts of the partners **Cr**

Particulars	P	Q	R	Particulars	P	Q	R
To Cash / Bank A/c (withdrawal) To balance c/d				By balance b/d(opening balance) By cash/Bank A/c(additional capital)			

Dr Current Accounts Cr

Particulars	A	B	C	Particulars	A	B	C
To balance b/d To drawings To interest on drawings To P & L appropriation To Balance c/d				By balance b/d(opening balance) By Interest on Capital By Salary By Commission By Profit and Loss appropriation A/c			

2) Fluctuating Capital Account Under this method only one account is maintained i.e. Capital account. It records all transaction relating to drawings, interest on drawings, interest on capital account, salary, commission, profit or loss share etc are recorded in the capital accounts. Then the capital account of each partner is balanced in usual manner.

Dr CAPITAL ACCOUNTS Cr

Particulars	P	Q	R	Particulars	P	Q	R
To drawings A/c To interest on drawings A/c To P & L appropriation A/c(Loss) To Balance c/d				By balance b/d(opening balance) By Interest on Capital A/c By Salary A/c By Commission A/c By Profit and Loss appropriation A/c (Profit)			

2.7 Following are some of the differences between Capital Account and Current Account:

Basis	Capital Account	Current Account
Objective	Main objective is to reveal the numerous details of capital account.	Main objective is that no partner should withdraw more than amount due to him.
Nature of account	Capital account in fixed capital method remains fixed from year to year.	Current account fluctuates from year to year.
Accounting treatment	Amount invested by the partner is to be recorded.	Transactions such as drawings, salary, and interest on capital are recorded.
Balance of account	Capital account in fixed method show only credit balance.	Current account can show a credit or debit balance
Need	Capital Account is opened in the case fluctuating capital method and fixed capital method	Current account is prepared only in case of fixed capital method.

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2.8 Difference between fixed capital method and fluctuating capital methods:

Basis	**Fixed Capital Method**	**Fluctuating Capital Method**
Numberof Accounts	Two accounts, viz., capital and current account.	One account, viz., capital account.
Nature of Account	Remains unaltered unless addition and withdrawn is made	Keep on changing from time to time..
Transaction	Transactions like interest on capital, drawings, interest on drawings, etc. are made in the current accounts.	All adjustments are made in the capital account.
Balance	Fixed capital account always shows a credit balance.	Fluctuating capital may show debit balance also.

2.9 The Appropriation of profit:

the net profit of the partnership business is to be shared by all the partners in the agreed profit sharing ratio. That is why one separate account is prepared for distribution of profits among the partners is known as profit &loss appropriation account. It includes interest on capital, interest on drawings, partner's salary, commission to partners, interest on loan and share of profit and loss.

A specimen of profit and loss appropriation account assuming that there are two partners; p and q. p is entitled for salary and q is entitled for commission and both will be provided and charged interest on capital and interest on drawings respectively

Profit & loss appropriation account for the year ended---

Particulars	RS	Particulars	Rs
To reserve a/c – transfer red to reserve To Interest on capital a/c P Q- To Interest on partner's loan a/c		By profit & loss a/c – Net profit By interest on Drawings a/c P – Q -	

To Partner's salary a/c – P To Partner's commission a/c – Q To Share of profit a/c (balancing figure) P- Q-			

For preparing the profit &loss appropriation account, the following journal entries have to be passed for various items.

JOURNAL ENTRIES:

A For interest on capital:

1 on allowing interest on capital:

Interest on capital A/c ------------Dr

To partners capital /current A/c

2 on closure of interest on capital account:

Profit & loss appropriation A/c --------Dr

To interest on capital A/c

B For Interest on Drawings:

1 On charging interest on drawings:

Partner's Capital/ Current A/c…Dr

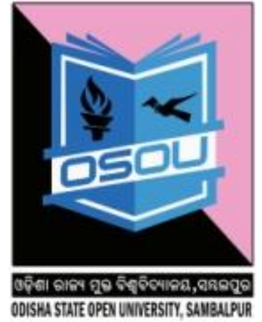
To interest on drawings A/c

2 On closure of interest on drawings:

Interest on Drawings A/c…Dr

To Profit & loss appropriation A/C

C For partners Salary/Commission/Bonus:



On allowing the same in above

Partners Salary/Commission/Bonus Account -Dr

To Partner's Capital / Current A/c

On closure of partners Salary/Commission/Bonus A/c

Profit & loss appropriation A/c --------Dr

To Partners Salary/Commission/Bonus Account

D Transfer to reserve:

Profit & loss appropriation A/c --------Dr

To Reserve A/c

E For transfer of share of profit or loss:

1 in case of divisible profit

Profit & loss appropriation A/c --------Dr

To Partner's Capital / Current A/c

2 in case of divisible loss

Partner's Capital / Current A/c---------Dr

To Profit & loss appropriation A/c

2.10 Special items to be treated:

Interest on Capital: Interest on capital is an expense to the firm and is debited to the profit and loss appropriation account. Interest is payable to the partners and hence, the partner's capital account is credited with the amount of interest.

Formula: amount of capital *Rate of interest* Period

Accounting treatment: being an appropriation out of profits shall be transferred to the debit of P& L Appropriation A/c and credit of the Partner's Capital A/c.

Interest on drawings: Average period should be used only when the amount of drawings is uniform and the time interval between two consecutive drawings is uniform. Interest on drawings is an income to the firm, and hence it is credited to the profit and loss appropriation account.

Formula: Amount of drawings *Rate of interest* Period

Accounting treatment: It should be credited to P& L Appropriation A/c.

Salary to partner: In all most all the partnership agreements ,provision for salary is included and amount of Partner remuneration is decided with mutual consent . A % of book profit is allowed as partner's remuneration .There are some conditions also which are to be complied to claim deduction of salary as expense in P & L account of partnership firm

1. Salary must be paid to working partner only.

2. Salary must be written/authorized by the Partnership deed and must be quantified.

3. Salary must be related to the period after the partnership deed date.

4. Salary allowed under income tax act will be limited to % of Book profit as given below.

Accounting treatment: being an appropriation out of profits shall be transferred to the debit of P& L Appropriation A/c and credit of the Partner's Capital A/c.

Interest on loan:

If any partner advances an amount over and above his/her commitment then it is considered as a partners' loan to the firm with a view to getting it back in the days to come from the partnership as per the valid partnership deed agreed upon. Whenever a partner provides a loan capital to the firm, then it should not be mixed up with his/her originally contributed capital account. Instead of writing in the capital account, a separate account is opened as partners' loan account.Interest on partners' loan to the firm is a charge against profit. Such interest is to be allowed whether there is profit or not. So, interest as a partners' loan is credited to his loan account and later on it is transferred to the debit of profit and loss account.

Rate of Interest- In case any partner has given loan to the firm; he is entitled to interest on such loan at an agreed rate of interest. If there is no agreement as to the rate of interest on loan, the partner is entitled to rate of interest on loan @ 6% per annum.

Accounting Treatment: Interest on loan is debited to P& L A/c and is credited to the Partner's Loan A/c.

Commission: Commission to a partner is to be allowed if the partnership agreement provides for the same. These are allowed only if there are profits.

Calculation- Commission may be allowed as a percentage of Net Profits before charging such commissions or after charging such commissions.

1. Commission as % of Net Profit before charging such Commissions

= Net profit before commission x Rate of commission/100

2. Commission as % of Net Profit after charging such Commissions

= Net profit before commission x Rate of commission/100 + Rate of Commission

Accounting Treatment: Commission to a partner being an appropriation out of profits shall be transferred to the debit of P& L Appropriation A/c and credit of the Partner's Capital A/c.

2.11 Numerical:

1. A, B & C are partners in a firm with capitals of Rs 50000, Rs 40000 &Rs 20000 respectively. They share profits & losses as: (1) up to Rs 10000 in the ratio of 4:3:3 (2) above Rs 10000, equally.

The net profit of the firm for the year ended 31st December,2016 amounted to Rs 40200 7 the drawings of the partners assuming: (a) partners capital are fixed (b) partner's capital are fluctuating, after considering the following adjustments:

- Interest on partner's capital to be paid @ 10%
- Interest on drawings to be charged @ 5%
- A to receive salary of Rs 5000 p.a.
- B & C to get commission @ 10% each on the net profit.

Solution:

Dr. Profit& Loss Appropriation account for the year ended 31st December,2016Cr

Particulars	Rs	Rs	Particulars	Rs	Rs
To Interest on Capital a/c A – Rs 5000 B – Rs 4000 C - Rs 2000		11000	By Profit & loss a/c – Net profit		40200
To Partner's salary a/c :A		5000	By Interest on Drawings a/c: A – 5% on Rs 6000 for 6 months	150	
			B – 5% on Rs 5000 for 6 months	125	
To Commission a/c: B – Rs 4020 C – Rs 4020		8040	C – 5% on Rs 3000 for 6 months	75	350
To share of profit a/c: A – Rs 6170 B – Rs 5170 C – Rs 5170		16510			
		40550			40550

(a) Fixed capital method:

Dr. **Partner's capital account** Cr

Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2016	To balance c/d	50000	40000	20000	1.1.2016	By balance b/d	50000	40000	20000

(b) Fluctuating capital method:

Dr.			Partner’s Capital account						Cr.
Date	Particulars	A	B	C	Date	Particulars	A	B	C
31.12.2016	To Drawings a/c	6000	5000	3000	31.12.2016	By Interest on Capital a/c	5000	4000	2000
	To Interest on Drawings a/c	150	125	75		By Partner’s salary a/c	5000	-	-
	To balance c/d	10020	8065	8115		By Commission a/c	-	4020	4020
						By share of profit a/c (Note1)	6170	5170	5170
		16170	13190	11190			16170	13190	11190

Working note:

Profit is shared as under:	A	B	C
Up to Rs 10000(4:3:3)	4000	3000	3000
Above Rs 10000(1:1:1)	2170	2170	2170
Share of profit	6170	5170	5170

Illustration: the partnership agreement of Manish and Garish provides that:

i. Profit will be shared equally.

ii. Manish will be allowed a salary of rs 400 p.m.

Iii. Garish who manages the sales department will be allowed a commission equal to 10% of the net profit after allowing Manish’s salary.

iv. 7% interest will be allowed on partner

v. 5% interest will be charged on partner’s fixed capital.

vi. The fixed capitals of Manish and garish are Rs. 1, 00,000 and Rs. 80,000 respectively.

Their annual drawings were Rs. 16,000 and Rs. 14,000 respectively. The net profit for the year ended March 31, 2002 amounted to Rs. 40,000.

Prepare firm Profit & Loss Appropriation Account.

Solution.

Particulars		Rs.	Particulars		Rs.
To Manish's Salary		4,800	By Net Profit as per Profit &Loss A/c		40,000
To Girish's Salary (10% of Rs. 35,200)		3.520	By Interest on Drawings:		
To Interest on Capital :			Manish (16,000x5/100)	800	
Manish	7,000		Garish (14,000 x5/100)	700	1,500
Garish	5,600	12,600			
To Capital A/cs (Divisible profit) :					
Manish 1/2	10,290				
Garish 1/2	10,290	20,580			
		41,500			41,500

Note: Average rat e of interest method will be applicable for calculating interest on drawings.

Illustration: X, Y and Z are in partnership with capital of Rs. 1, 20,000 (Credit), Rs. 1, 00,000 (Credit) and Rs. 8,000 (Debit) respectively ort 1st April, 1997. Their partnership deed provides the following:

(i) Partners are to be only allowed interest on capital @ 5% p.a. and are to be charged interest on drawings @ 6% p.a.

(ii) X is entitled to a remuneration of 10% of the net profit for securing contacts with customers.

(iii) Y is also entitled to a commission of 10% of the net profit after charging clause (ii) above.

(iv) Z is entitled to a rent of Rs. 1,000 per month for the use of his premises by the firm.

During the year, X withdrew Rs. 200 at the beginning of every month, Y Rs. 300 during the month and Z Rs. 400 at the end of every month.

The net profit of the firm for the year ended 31st March, 1998, before providing for any of the above clauses was Rs. 1, 11,000.

From the above you are required to draft only the Profit and Loss Appropriation Account for the year ended 31st March, 1998. (All calculations are to be made nearest to the rupee).

Profit & Loss Appropriation Account

Dr. for the year ended 31st March, 1998 Cr.

	Rs.	Rs.		Rs.	Rs.
To Interest on Capital			By Net Profit as per P/L A/c	1,11,000	
	6,000			12,000	99,000
X	5,000	11,000	Less : Rent paid to Z		
		9,900		78	
Y			By Interest on Drawings	108	
		8,910	X (2,400 x 6/100 x 65/12)	132	318
To X's Commission (99,000 x 10/100)	Total (Dr.)	29,810		Total (Cr.)	99,318
To Y's Commission	Rs.		Y (3,600 x 6/100 x 6/12)		
(99,000 — 9,900 = 89,100 x 10/100)	23,169		Z (4,800 x 6/100 x 55/12)		
	23,169				
	23,170	69,508			
To Divisible Profit transferred to Capital A/c s : X 1/3, Y 1/3, Z 1/3		99,318			99,318

Note: 1.Since partners are to be allowed interest on capital only hence interest on Z'capital has not

been charged.

2. Since rent paid to Z is a business expense, hence it should be shown in Profit & Loss A/c.

Illustration: Ted, Phil and Gordon are in Partnership sharing profits two-fifths, two-fifths

and one-fifth and throughout the half year ended 31st December 2001 their capital accounts have remained unchanged at Rs. 60,000, Rs. 40,000 and Rs. 30,000 respectively.

Their current accounts balances on 1st July 2001 were:

Phil : Rs. 8,550 (Dr.)

Gordon : Rs. 6,550 (Dr.)

Ted : Rs. 12,000 (Cr.)

During 2001, Ted withdrew Rs. 200 at the beginning of each month, Gordon withdrew Rs. 400 at the end of each month while Phil withdrew Rs. 1,800 during the period of six months. Their partnership deed provides that :

(a) Partners are allowed interest on capital @ 5% p.a.

(b) Partners are allowed or charged interest on current account balances @ 4% p.a.

(c) Interest on drawings @ 6% p.a.

(d) Gordon is entitled to a salary of Rs. 500 per month.

(e) Ted is entitled to a commission of 5% of the correct net profit of the firm.

(f) Phil is entitled to a commission of 5% of the correct net profit of the firm after charging such commission.

During the half year ended 2001, the net profit of the firm was Rs. 2,07,000 after charging Gordon's salary which had been debited to wages and salaries account.

You are required to prepare the profit and loss appropriation account of the firm only.

Profit & Loss Appropriation Account

for the year ended 31st December, 2001

		Rs.			Rs.
			Net Profit as per P/L A/c	2,07,000	
To Interest on Capital :	1,500		*Add :* Gordon Salary (500 x 6)	3,000	2,10,000
T (60,000 x 5/100 x 6/12)	1,000		By Interest on Current A/cs :		
	750	3,250	P (8,550 x 4/100 x 6/12)	171	
P (40,000 x 5/100 x 6/12)			G (6,550 x 4/100 x 6/12)	131	302
		240	By Interest on Drawings :		
G (30,000 x 5/100 x 6/12)		3,000	T (1,200 x 6/100 x 3.5/12)	21	
		10,500	G (2,400 x 6/100 x 25/12)	30	
		10,000	P (1,800 x 6/100 x 3/12)	27	78
To Interest on Current A/cs :					
T (12,000 x 4/100 x 6/12)	73,356				
	73,356				
To G's Salary (500 x 6)	36,678	1,83,390			
To T's commission (2,10,000 x 5/100)		2,10,380			2,10,380

Illustration: Small, Big and Long own Large Enterprises, with Fixed Capitals of Rs. 2, 00,000, Rs. 4,00,000 and Rs. 6,00,000 respectively. Their current account balances on 31.3.2001 are Rs. 50,000, Rs. 1, 00,000 (Dr.) and Rs. 1, 50,000 (Dr.) respectively.

On 1.4.2001, they adopt the Fluctuating Capital Method of accounting, i.e., they transfer their current account balances to the capital accounts on this given date. The clauses of the Partnership Deed provide for :

(a) Interest on Capital @ 10% p.a. (now on the Fluctuating Capital balances as from 1.4.2001).

(b) A monthly allowance of Rs. 6,000, Rs. 4,000 and Rs. 3,000 for Big, Long and small respectively is to be accounted for.

(c) Loan Capital of a partner earns him interest @ 20% p.a. (which interest is compulsory to drawn in cash, by the concerned partner each year, on the last date).

(d) A 10% Reserve is to be set aside on the years on the last date.

(e) Profit-sharing ratio is 1 : 1 : 2 for Small, Big and Long respectively.

Compile the Profit and Loss Appropriation Account and the capital accounts of the partners for the year

2001-2002. Net Profit before interest and salary is Rs. 5, 00,000. Long Loan Capital reflects a credit balance of Rs. 1, 50,000. The monthly Drawings for 2001-02 of each totaled to Rs. 25,000 for the year.

Profit & Loss Appropriation Account

for the year ended 31st March, 2002

Dr cr

		Rs.			Rs.
To Interest on Capital :					
Small of (Rs. 2,50,000 x 10/100 x 1)	25,000		By Net Profit		
Big of (Rs. 3,00,000 x 10/100 x 1)	30,000		Net Profit before interest	5,00,000	
Long of (Rs. 4,50,000 x 10/100 x 1)	45,000		*Less :* Interest on loan		
		1,00,000	@ 20% on Rs. 1,50,000	30,000	4,70,000
To Monthly Allowance A/c					
Big (6,000x 12)	72,000				
	48,000				
Long (4,000 x 2)	36,000	1,56,000			
		47,000			

Particulars	Rs.	Rs.	Particulars	Rs.
Small (3,000 x 10)				
To Reserve (10% on Rs. 4,70,000)				
To Capital A/cs (Profit) :				
Small 1/4	41,750			
Big 1/4	41,750	1,67,000		
Long 2/4	83,500			
		4,70,000		4,70,000

Partner's Capital Account

Particulars	Small	Big	Long	Particulars	Small	Big	Long
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Current A/c (Tr.)	--	1,00,000	1,50,000	By Bal. b/d	2,00,000	4,00,000	6,00,000
To Balance c/d	2,50,000	3,00,000	4,50,000	By Current A/c (Tr.)	50,000	-	-
	2,50,000	4,00,000	5,50,000		2,50,000	4,00,000	5,50,000
				By Balancing b/d	2,50,000	3,00,000	4,50,000
To Drawings A/c	25,000	25,000	25,000	By Int. on Capital	25,000	30,000	45,000
To Balance c/d	3,27,750	4,18,750	6,01,500	By Monthly Allow.	36,000	72,000	48,000
				By P/L App A/c	41,750	41,750	83,500
	3,52,750	4,43,750	6,26,500		3,52,750	4,43,750	6,26,500

Partner's Current Account

Particulars	Small	Big	Long	Particulars	Small	Big	Long
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Balance b/d	-	1,00,000	1,50,000	By Bal. b/d	50,000	-	-
To Capital A/c (Tr.)	50,000	-	-	By Capital A/c (Tr.)	-	1,00,000	1,50,000
	50,000	1,00,000	1,50,000		50,000	1,00,000	1,50,000

Illustration: Ms. Bubble and Mr. Blow, each doing business as sole proprietors, started a partnership Glow Food Products on first April, 2001

Ms. Bubble brought in machinery valued at Rs. 5, 50,000 whereas Mr. Blow brought in office equipment costing Rs. 50,000 and 50% of a Legacy of Rs. 15,00,000, she had inherited.

Mid-year on 30.9.2001, Mr. Blow invested Rs. 1,00,000 as loan capital, but claimed interest @ 20% p.a. (agreed upon because the firm needed working capital).

(a) Interest on capital allowed @ 10% p.a. and Interest on Drawings @ 10% p.a. to be charged only on the monthly uniform drawings of each.

(b) Loan capital, if introduced, bears interest.

(c) A Holiday Allowance of Rs. 7,000 each to be appropriated for the yearly net profit (drawn in cash on 30th September of the year by each of them).

(d) Account for an Entertainment Allowance for Mr. Blow, @ Rs. 1,000 per month.

(e) Account for a 2% commission earning on gross profit for Ms. Bubble. (Gross Profit = 5 times the year's Net profit in the first year).

(f) The maximum permissible amount of monthly drawings is Rs. 5,000 each whilst Mr. Blow withdrew this amount, Ms. Bubble drew only Rs. 3,000 per month.

Compile the profit & Loss Appropriation Account for the first year and the Partner's Personal accounts. Net profit before interest Rs. 2, 10,000 for 2001-02.

		Rs.			Rs.
To Interest on Capital :			By Net Profit as per		
Bubble (10% on 5,50,000)	55,000		Profit &Loss A/c :		
	80,000	1,35,000		2,10,000	
Blow (10% on 8,00,000)			Net Profit before Interest		
	7,000			10,000	2,00,000
To Holiday Allowance :	7,000	14,000	*Less :* Interest on Loan		
		12,000	(1,00,000 x 20/100 x 6/12)	1,650	
Bubble					
Blow				2,750	4,400
		20,000	By Interest on Drawings :		
To Blow's Entertainment Allowance			Bubble (36,000 x 10/100 x 5.5/12)		
	11,700		Blow (60,000 x 10/100 x 5.5/12)		
To Bubble's Commission :					
	11,700	23,400			
(OD 2% on Rs. 10,00,000)					
To Capital A/cs (Profits) :		2,04,400			2,04,400

Particulars	Bubble	Blow	Particulars	Bubble	Blow
To Drawings	43,000	67,000	By Machinery	5,50,000	
To Interest on Drawings	1,650	2,750	By Office Equipments		50,000
To Balance c/d	5,99,050	8,40,90	By Bank A/c		7,50,000
			By Interest on Capital	55,000	80,000
			By Holiday Allowance	7,000	7,000
			By Entertainment Allowance		12,000
			By Commission A/c	20,000	
			By P/L App. A/c	11,700	11,700
	6,43,700	9,10,700		6,43,700	9,10,700

Particulars	Bubble	Blow	Particulars	Bubble	Blow
To Drawings	43,000	67,000	By Machinery	5,50,000	
To Interest on Drawings	1,650	2,750	By Office Equipments		50,000
To Balance c/d	5,99,050	8,40,90	By Bank A/c		7,50,000
			By Interest on Capital	55,000	80,000
			By Holiday Allowance	7,000	7,000
			By Entertainment Allowance		12,000
			By Commission A/c	20,000	
			By P/L App. A/c	11,700	11,700
	6,43,700	9,10,700		6,43,700	9,10,700

Solution

Profit & Loss Appropriation Account

Partner's Capital Account for the year ended 31st March, 2002

	Rs.		Rs.
To Balance	1,10,000	By Bank A/c	1,00,000
		By Interest A/c	10,000
	1,10,000		1,10,000

Notes:

(1) Interest on total drawings of each partner for the year has been calculated on average for 5.5 months on the assumption that drawings were made at the end of each month.

(2) Interest on drawings will not be charged on holiday allowance Rs. 7,000 as it is drawn out of profit.

Sum up: Partnership as an association of two or more persons who have agreed to share the profits of a business which they run together. The persons who own the partnership business are individually called 'partners' and collectively they are called as 'firm' or 'partnership firm'. The name under which partnership business is carried on is called 'Firm Name'.in the absence of partnership deed, the partners will share the firm`s profit and losses equally. Partners are entitled to get interest loan and advances @ 6%p.a. No interest will be allowed to partners on their capital contribution and no partner is entitled to get any salary, commission, bonus for the services rendered by them.

Key terms:

Charge against profit: It is the deduction from revenue to ascertain net profit or net loss.

Capital account: it is a general ledger account used for recording the amounts an investor pays to the company and the cumulative amount of the company's earnings minus cumulative distributions to the owners.

Current account: is prepared when capital is fixed. Transactions such as drawings, salary, and interest on capital and drawings are recorded.

Partner's Drawings: Partner's drawings generally refer to amounts withdrawn by partners from the partnership business in anticipation of their share of profits for meeting their private or domestic expenses.

Interest on Drawings: Sometimes interest is not only allowed on capitals but is also charged on drawings. In such case

Fixed Capital method: Under this method the capital invested by the partners remains constant unless additional capital is brought in or some part of the existing capital is withdrawn permanently by agreement.

Fluctuating Capital Account: Under this method only one account is maintained i.e. Capital account. It records all transaction relating to drawings, interest on drawings, interest on capital account, salary, commission, profit or loss share etc are recorded in the capital accounts.

Appropriation of profit: The net profit of the partnership business is to be shared by all the partners in the agreed profit sharing ratio.

Profit and loss account: it is an account that shows the quantum of surplus funds available to the entity at the end of a financial period.

Profit and loss appropriation account: gives the details about how the surplus that is shown in the profit and loss account is going to be spent.

Self-assessment Questions:

1 Menon and Thomas are partners in a firm. They share profits equally. Their monthly drawings are Rs. 2,000 each. Interest on drawings is to be charged @10% p.a. Calculate interest on Menon's drawings for the year 1989 assumingdrawings are made (i) in the beginning of every month, (ii) in the middle ofevery month, and (iii) at the end of every month.

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2 On March 31, 2003, after the close of books of accounts, the capital accountof Ram, Shyam and Mohan showed balance of Rs. 24,000, Rs. 18,000 andRs.12, 000 respectively. But, it was later discovered that interest on capital@ 5% had been omitted. The profit for the year ended March 31, 2003, amounted to Rs. 36,000 and the partners drawings had been Ram Rs. 3,600,ShyamRs. 4,500 and Mohan Rs. 2,700. The profit sharing ratio of Ram,Syham and Mohan was 3:2:1. Calculate interest on capital.

3 Lokesh and Azad are partners sharing profits in the ratio 3:2 with capitals of Rs. 50,000 andRs.30,000 respectively. Interest on capital is agreed @ 6%p.a. Azad is allowed a salary of Rs. 2,500 p.a. During 2002, the profits for the year prior to the calculation of interest on capital but after charging Azad's salary amounted to Rs. 12,500. A provision of 5% of profits is to be made in respect of manager's commission. Prepare an account showing the allocation of profits and partner's capital accounts.

Model Questions:

(i)What is partnership? State the chief characteristics of a partnership? Describe the main provisions of the Partnership Act that are relevant topartnership accounts.

(ii)Distinguish between:

A)Fixed and Fluctuating methods of capital.

b) Average Profits and Super Profits.

(iii) Illustrate how interest on drawings will be calculated under various

Situations?

(iv)Define goodwill. Describe various methods of valuing goodwill.

Further Readings:

1. Modern Accountancy: Hanif and Mukherjee, volume –I, Tata Mcgrawhill.

2. Higher secondary Accounting: Biswal and Sharma.

3. Financial Accounting: P.C. Tulsian, Pearson.

4. An Introduction to Accountancy: S.N. Maheshwari, S.K. Maheshwari. Vikas.

Unit –III : ADMISSION OF A PARTNER

Learning objectives:

After studying this lesson, you will be able to know:Meaning of Admission of a partner, need for Admission of a partner.Meaning of New profit sharing ratio, gaining ratio, Meaning of goodwill, various kinds of goodwill, Need for valuation of goodwill and various types of valuation of goodwill.

Structure:

3.1Introduction

3.2 Meaning of Admission of a partner.

3.3 Need for admission of a partner.

3.4 Partner's new profit sharing ratio

3.5 Partner gaining ratio

3.6Details of Goodwill

3.7Problem and Solution

3.1 Introduction:

Sometimes, it becomes difficult to run the partnership business due to lack of sufficient capital or managerial help or both. In this case a firm may decide to admit a new partner into the firm. But according to Indian Partnership Act 1932, no partner can be admitted into the firm without the consent of all the existing partners. A person who is admitted as a partner into the firm does not thereby becomes liable for any act of the firm done before his admission.

3.2 Concept and Meaning of Admission of New Partner:

During the ordinary course of business the partnership business may need additional capital, special skill, When because of the same reasons, or for some other importance if a partnership welcomes outsiders as a partner in the business it is called as admission of a partner. Before giving admittance to new partner there should be a clear-cut consent between or among the partner for the same otherwise it may cause a reason of dissolution of partnership.

ଓଡ଼ିଶା ରାଜ୍ୟ ମୁକ୍ତ ବିଶ୍ୱବିଦ୍ୟାଳୟ,ସମ୍ବଲପୁର
ODISHA STATE OPEN UNIVERSITY, SAMBALPUR

3.3 Reasons For admission of a new partner:

A partner is admitted for any one or more of the following reasons:

i. In order to acquire more capital for the business.

ii. In order to have more managerial skill, a competent and experienced person is needed.

iii. In order to expand and boost up the business.

iv. In order to increase the goodwill by admitting a well-reputed person into the business.

v. In order to reduce the competition.

vi. To take advantage of the experience, reputation and goodwill of the incoming partner etc.

Admission of a new partner results in the reconstitution of a partnership firm ending the existing agreement. Hence a new partnership agreement comes into existence. A new partnership deed is prepared at the time of admission of the new partner.

Effects of admission of a new partner:

A newly admitted partner acquires two main rights in the firm:

1. Sharing in the future profits of the firm.

2. Sharing in the assets of the firm

Adjustments are needed at the time of the admission of a new partner:-

1. Calculation of new profit sharing ratio.
2. Accounting treatment of goodwill.
3. Accounting treatment for revaluation of Assets and Liabilities.
4. Accounting treatment of reserves and accumulated profits.
5. Adjustment of capitals on the basis of new profit sharing ratio.

3.4 New Profit Sharing Ratio:

Meaning: The ratio in which all partners including new partner share the future profits and losses is known as the new profit sharing ratio.

Calculations:

1. When only the ratio of new partner is given in the question, then in the absence of any instructions. It is presumed that the old partner will continue to share the remaining profits in the same ratio in which they were sharing before the admission of a new partner.

2. The new partner "purchases" his share of profit from the old partners equally. In such cases the new profit sharing ratios of the old partners will be as certained by deducting the sacrifice made by them from their existing share of profits.

New Profit Ratio = Old Ratio - Sacrifice

3. The new partner "purchases" his share of profit from the old partners in particular ratio. In such cases the new profit sharing ratio of the old partners will be calculated after deducting the sacrifice made by a partner from his existing share of profit.

New Profit Ratio = Old Ratio – Sacrifice

4. When the old partners surrender a particular fraction of their share in favour of the new

Partner then

Surrendering Share = Surrendered Share X Old Ratio.

New Ratio = Old Ratio - Surrendering Share.

Sacrifice Ratio = Old Ratio -New Ratio.

3.5 gaining ratio:

Gaining Ratio is calculated at the time of retirement or death of partner. It is the excess of new ratio over old ratio of old partners except retire or dead partner.

Gaining Ratio = New Ratio - Old Ratio

We can understand this ratio as the share of profit which is given by retired partner to the partners who are still exist in partnership firm

Difference between sacrificing and gaining ratio:

1. Sacrifice ratio is calculated at the time of admission of new partner but gaining ratio is calculated at the time of retirement of a partner.

2. Total of each old partner's Sacrifice will be equal to new ratio of new admitted partner. total of gaining share of each partner will be equal to the old ratio of retired partner.

3. Goodwill will be distributed at the time of admission in sacrifice ratio. Goodwill will be distributed at the time of retirement in gaining ratio.

4. Difference of old ratio and sacrifice ratio will be new ratio but total of old ratio and gaining ratio will be new ratio.

3.6 Goodwill:

Concept:

The name and fame of an organization can be termed as goodwill. Goodwill is the beneand merit of good name and reputation. Goodwill refers to a measure of the capacity of a business to earn excess profit. Therefore, goodwill can be defined as an intangible asset of the business.

Thus, goodwill may also be defined as "value of the reputation of business". It is a valuable asset if the concern is profitable. It is useless if the concern is a losing concern. Goodwill can be described as the extra sale able value attached to a prosperous business beyond the intrinsic value of net assets.

Types of good will:

Goodwill is generally of two types:

1 purchased goodwill: it arises when one new business is purchased and the purchase consideration is more than the value of net tangible assets received from the business.

2 inherent goodwill: it arises when a business may over the years generate its own goodwill.

Need for valuation of good will:

1. In the case of sole trading concern, goodwill is valued at the time of selling of business, to take any person as a partner, to convert sole trading concern into a company.

2. In the case of partnership, when there is an admission, retirement and death of partner, amalgamation, conversion into a company and change in profit sharing ratio.

3. In the case of company, goodwill is valued at the time of amalgamation of two or more companies, absorption of company, reconstruction and holding company. The valuation of goodwill also becomes necessary, if the shares have to be valued on the basis of intrinsic value, market value or fair value and if the stock exchange quotation of the value of shares of a company is not available.

4. For taxation purpose such as wealth tax also, the valuation of goodwill is necessary.

Valuation of Goodwill: methods to be adopted in valuing goodwill should be mentioned in the partnership deed. If nothing is mentioned in the partnership deed then valuation should be done as per the agreement among the partners. Some of the various methods of goodwill here as under:

(a) Average Profits Basis:

In this method, the profits of the past few years are averaged and adjusted for any change that is expected to occur in the near future. The adjusted average is multiplied by a certain number (say, 2 or 3 or 5) as agreed. It is expressed, for example, as 3 years' purchase of five years' average profits. If, for example, the profits for the last five years have been Rs 80,000, Rs 90,000, Rs 70,000 Rs 85,000 and Rs 1, 00,000; the average yearly profit comes to

=80,000+ 90000+ 70000+85000+100000/5=85000.

If, goodwill is to be valued at 3 years' purchase of average profits for. 5 years, goodwill will be Rs 85,000 x 3 = Rs 2, 55,000.

(b) Super Profits Basis:

In every industry, there is a rate which is considered to be the normal rate at which profits are expected to the earned on capital employed. If a firm is able to earn more than the normal expected profit, the excess is called super profits which can be attributed to the special advantages of firm.

Suppose, the capital of the firm is Rs 4, 00,000 and that 15% is reasonable return in the industry. The reasonable or normal profits are Rs 60,000. If the average profits are Rs 85,000, the super profits in this case come to Rs 25,000. Super Profits multiplied

by the number of years' purchase agreed upon gives goodwill. In the example given above, if goodwill is to be calculated at 3 years' purchase, the goodwill is Rs 75,000 i.e. Rs 25,000 x 3.

(c) Capitalization Method:

In this method, the value of the whole business is found out by the formula, then, from this figure, the net assets (excluding goodwill) of the firm are deducted and the remainder is goodwill. In the example given above, the value of the whole business is 85000/15% or 5, 66,667. Net assets (excluding goodwill) or capital is Rs 4, 00,000. Hence, the goodwill is Rs 1, 66,667 i.e. Rs 5, 66,667—Rs 4, 00,000.

(d) Capitalization of super profit method: in this method good will is calculated by capitalizing super profits at agreed rate. Here goodwill is dividing the capitalization ratio with the difference between adjusted forecast maintainable profit and rate of return on capital employed.

Suppose the adjusted forecast maintainable profit is Rs 80000; normal rate of return 20% capital employed is Rs 400000and capitalization rate 20%.

Goodwill= 80000-- 400000*15% / 20%= Rs100000.

(e) Annuity method: in this method goodwill is calculated by considering the average super profit as the value of an annuity over a certain number of years. The formula for calculation of goodwill is: average super profit * Annuity.

Suppose, average profit of last five years is Rs 200000: normal rate of return on capital employed of Rs 5ooooo is 20%

Goodwill = (200000—500000*20%)* 3.7907= Rs379070.

Accounting Treatment of Goodwill:

On the Admission of a Partner:

1. When the amount of goodwill (premium) is paid privately.

   : - No Entry

2. When the new partner brings his share of goodwill (premium) in cash:

a.) When the amount of goodwill/ premium brought in by the new partner is retained in

The business:-

i.) Cash/ Bank A/c Dr.
To goodwill A/c

ii.) Goodwill A/c Dr (in sacrifice ratio)
To Old partners' capital A/c

b.) When goodwill/premium brought in by the new partner is withdrawn by the old partners:-

I.) Old Partners' capital A/c Dr.

To Cash / Bank A/c

* When goodwill already appears in the books and new partners brings his share of goodwill/premium in cash:-

First of all the existing goodwill account will have to be written off. For this purpose old partners' capital accounts are debited in old ratio and goodwill account is credited.

Old partners' capital A/c Dr.
To goodwill A/c (in old ratio)

Remaining entries remains same for bring goodwill in cash.

* When the new partner does not bring his share of goodwill/premium in cash:-

New partner's current A/c Dr. (From his share of goodwill)

To old partners' capital A/c (in sacrifice ratio)

* When goodwill already appears in the books and new partner does not bring his share of goodwill/premium in cash:-

i.) Old partners' capital A/c Dr.

To goodwill A/c (in old ratio)

ii.) New partner's current A/c Dr.

To old partner's capital A/c (in sacrifice ratio)

* When new partner brings in only a part of his share of goodwill:-

i.) Cash/bank A/c Dr.

To goodwill A/c

ii.) Goodwill A/c Dr.

New partner's current A/c Dr.

To Old partner's capital A/c (in sacrifice ratio)

3.8 Revaluation of assets & liabilities:-

Revaluation account:-

Account which is prepared to record changes in the value of assets & liabilities at time of admission, retirement, death and change in profit ratio of existing partners.

Proforma of Revaluation Account is given below:-

Particulars	Amount	Particulars	Amount
To Decrease in value of assets To Increase in value of liabilities To Unrecorded liabilities To Profit on revaluation transferred to partner's capital accounts (in old ratio)		By Increase in value of assets By Decrease in value of liabilities By unrecorded assets By loss on revaluation transferred to partners' capital accounts (in old ratio)	

Accounting treatment:

For decrease in the value of assets & increase in the value of Assets / unrecorded Assets:-

1. Revaluation A/c Dr.

   To assets A/c (decrease)

2 Assets A/c Dr.

   To revaluation A/c (increase)

3 Unrecorded assets A/c Dr.

To revaluation A/c

For increase/decrease of liabilities or unrecorded liabilities:

1 Revaluation A/c. Dr.

To liabilities A/c (increase)

2. Liabilities A/c Dr.

To Revaluation A/c (decrease)

3. Revaluation A/c Dr

To unrecorded liabilities A/c

Revaluation A/c shows profit or loss:-

1. Revaluation A/c. Dr. (in profit)

To Old partners' capital A/c (in old ratio)

2. Old partners' capital A/c. Dr. (In loss)

To revaluation A/c (in old ratio)

Accounting treatment of reserves and accumulated profits or losses:-

For distributing reserves and accumulated profits among old partners in old ratio -

General reserve A/c Dr.

Reserve A/c Dr.

P&L A/c {cr. Balance} Dr.

To old partners' capital a/c / current a/c.

For distributing accumulated losses among old partners in old ratio-

Old partner's capital A/c Dr.

To P&L A/c {Dr. Balance}

For distributing surplus of specific funds:-

Workmen's compensation fund A/c Dr.
Investment fluctuation fund A/c Dr.
To Old Partner's Capital a/c. /Current a/c.

Adjustment of old partner's capital accounts on the basis of new partner's capital:- If the existing capital of any partner is less than his newly calculated capital:-

Bank A/c / Partner's Current a/c. Dr.

To Old Partner's Capital A/c.

If the existing capital of any partner is more than his newly calculated capital:

Old Partner's Capital A/c. Dr.

To Bank A/c. / Partner's Current A/c.

Adjustment in regard to profit sharing ratio:

When new partner is admitted existing partners sacrifice certain portion of their share to the incoming partner. A new profit sharing ratio is made among the old and new partners.

Example:

(1) A & B are in partnership sharing profits & losses in the ratio of 3:2. C is admitted as a partner for 1/4th share. Now, after admission, the new profit sharing ratio will be as:

Remaining profit sharing ratio for A & B = 1-1/4= 3/4

A= 3/5 * 3/4 = 9/20
B = 2/5 * 3/4 = 6/20
C = 20 – (9 + 6) / 20 = 5/20
A: B: C = 9:6:5
(2) A & B are partners sharing profits & losses in the ratio of 3:2. They admit C into the firm for 3/7th shares of profit which he takes 2/7 from A & 1/7 from B. The new profit sharing ratio will be as:

A = 3/5 – 2/7 = (21 – 10)/35 = 11/35
B = 2/5 – 1/7 = (14 – 5)/35 = 9/35
C = 35 – (11 + 9)/35 = 15/35
A: B: C = 11:9:15
Adjustment in regard to Goodwill

Illustration 1:

A and B share profits in the ratio: A, 5/8 and B 3/8. C is admitted as partner. He brings in Rs 70,000 as his capital and Rs 48,000 as goodwill. The new profit-sharing

ratio among A, B and C respectively is agreed to be 7: 5: 4 respectively. Pass Journal entries.

A and B share profits in the ratio:g 1/3 and p 2/3. C is admitted as partner. She brings in Rs 90,000 as his capital and Rs 58,000 as goodwill. The new profit-sharing ratio among A, B and C respectively is agreed to be 3: 2: 1 respectively. Pass Journal entries.

A previously received 5/8 and now will receive 7/16; his loss is 5/8—7/16=3/16. Similarly B`s loss is 3/8—5/16=1/16. C`s Share will be 3/16+1/16=4/16

Journal Entries

Date	Particulars	L.F.	Rs.	Rs.
	Bank Account -------------------DR To C`s capital Account (being the amount brought in by C both as capital and goodwill)		118000	 118000
	C`s capital Account --------------------Dr To A`S capital Account To B`s Capital Account (Being goodwill brought in byA credited to old partners capital account in the sacrificing ratio,and new partner`scapital account is debited.)		48000	 36000 12000
	B`s Capital Account --------------------Dr C`s Capital Account -------------------Dr To Bank Account------------------		36000 12000	 48000

In the above illustration, the old partners have allowed the amounts of goodwill credited to their capital accounts remain in the business. However, the arrangement may allow the old partners to wholly or partly withdraw the amounts of goodwill credited to their capital accounts. Suppose, in the above illustration, A and B withdraw their shares of goodwill A and B withdraw their shares of goodwill brought in by C.If the case is that the amount of goodwill is paid by the new partner to the old partners privately, no entry is passed in the books of the firm. But the calculations have be made in the same manner as shown above.

Accounting Treatment of Goodwill:

Because of the provisions of the Accounting Standard 10 on Accounting for Fixed Assets, accounting treatment of goodwill has undergone a fundamental change.

Consider extract of the Accounting Standard which runs as follows:

Goodwill should be recorded in the books only when some consideration in money or money's worth has been paid for it. Whenever a business is acquired for a price (payable in cash or in shares or otherwise) which is in excess of the value of net assets of the business taken over, the excess should be termed as 'goodwill'.

It means that goodwill can appear in the books only when it has been paid for. When a business is acquired and the consideration paid for it exceeds the fair amount paid for net assets other than goodwill, such excess can be recorded as goodwill.

Suppose, P and Q are equal partners in a firm. They take over the business of XY (Pvt.) Ltd. for Rs 20, 00,000 payable in cash.

On the date of the takeover, the abridged balance sheet of the private company is as follows:

Balance sheet of XY (Pvt) Ltd

as at ----------

Liabilities	Rs	Assets	Rs
Paid-up share capital	14,00,000	Machinery	9,50,000
Reserve	4,80,000	Furniture	1,04,000
Sundry Creditors	3,12,000	Stock	8,26,000
		Debtors	3.00.000
		Cash at Bank	12,000
	21,92,000		21,92,000

The firm takes over all the assets and liabilities at book values except that machinery is valued by an expert at Rs 8, 94,000 and a provision for bad debts @2% is created against debtors.

The journal entries in the books of the partnership firm will be as follows:

Date	Particulars	L.F.	Dr.	Cr
	Business Purchase Account --------------Dr		20,00,000	
	To Liquidator of XY Pvt Ltd. Account --(Being Consideration payable to liquidator of XY Ltd for the business taken over)			20,00,000
			8,94,000	
	Machinary Account --------------------		1,04,000	

	---Dr Furniture Account----------------------Dr Stock Account--------------------Dr Debtors Account--------------------Dr Cash at Bank Account---------------------Dr Goodwill Account--------------------Dr To Provision for Bad Debt Account------ To Sundry Creditors Account-------------- To Business Purchase Account ---------- (Being agreed values of assets and liabilities taken over, the balancing figure being treated as payment for goodwill. Liquidator of XY Pvt Ltd. ---------------Dr To Bank Account -------------- (Being Payment of cash to liquidator of XY Pvt Ltd. In discharge of consideration for business.)		8,26,000 3,00,000 12,000 1,82,000 20,00,000	 6,000 3,12,000 20,00,000 20,00,000

A firm cannot raise a goodwill account for internally generated goodwill although it may be sure that if it sells its business, it will be able to get a certain sum of money for its goodwill. In this connection, paragraphs 35, 36 and 37 of Accounting Standard 26 on Intangible Assets (issued in 2002) are noteworthy.

These paragraphs run as follows:

35. Internally generated goodwill should not be recognized as an asset:

36. In some cases, expenditure is incurred to generate future economic benefits, but it does not result in the creation of an intangible asset that meets the recognition criteria in this statement. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognized as asset because

it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.

37. Difference between the market value of an enterprise and the carrying amount of its identifiable net assets at any point of time may be due to a range of factors that affect the value of the enterprise. However, such differences cannot be considered to represent the cost of intangible assets controlled by the enterprise.

The effect of the abovementioned provisions is that the question of raising goodwill account on a change in profit sharing ratio among partners, admission of a new partner or retirement of a partner or death of a partner does not arise any longer. However, in any one of the abovementioned cases, the partners may agree upon a value of internally generated goodwill and an appropriate adjustment entry involving the capital accounts of the concerned partners may be passed.

Change in the Profit-sharing Ratio:

If partners decide to share profits in future in a ratio different from the one hitherto, the gaining partner must compensate the losing partner unless otherwise agreed upon. The compensation is the value of goodwill represented by the gain because the change in profit-sharing ratio means that one partner is purchasing from another partner a share of the profits previously belonging to the latter. Suppose, A and B, are partners sharing profits in the ratio of 3: 1 respectively. It is decided that in future both will be equal partners; it means that A is selling to B 1/4th share of profits.

Therefore, B will pay to A an amount equal to one-fourth of the total value of goodwill. In concrete terms, suppose, the profit is Rs 60,000, previously A would get Rs 45,000 and B would get Rs 15,000. After the change in the profit-sharing ratio, each would get Rs 30,000 A, therefore, loses annually Rs 15,000 and B gains Rs 15,000. If the goodwill is valued at Rs 1, 50,000, B must pay A one-fourth of Rs 1, 50,000 viz., Rs 37,500.

Illustration :

A, B and C are partners who were sharing profits in the ratio of 6:5:2 respectively. On 1st April, 2010, they, agree to become equal partners. The value of firm's goodwill is agreed upon to be Rs 78,000. Pass the necessary adjustment entry.

Date	Particulars	L.F.	Dr	Cr
	C`s capital Account -------------------------Dr To A`s Capital Account--------------------- To B`s Capital Account --------------- (Being adjustment entry in respect of goodwill on changed profit sharing ratio.)		14,000	 10,000 4,000.

Old profit sharing ratio amoung A,BandC = 6:5:2

New profit sharing ratio amoung A,BandC = 1:1:1

C`s gain 1/3 – 2/13 = 7/39

Sacrificed by A 6/13-- 1/13= 5/39

Sacrificed by B 5/13—1/13= 2/39

Ratio of sacrificed between A and B 5/39: 2/39

Total value of goodwill = Rs 78,000

C`s gain in Goodwill 7/39 of 78,000 = 14,000

Out of it,A`s gain in Goodwill 5/7 of 14,000 = 10,000

And B`s gain 2/7 of 14,000 = 4,000.

Illustration :

X and Y were partners sharing profits in the ratio of 5:4 respectively. On 1st April, 2012 they admitted Z as a new partner; all the partners agreeing to share future profits equally. On the date of admission of the new partner, there was a goodwill account in the old firm's ledger showing a balance of Rs 18,000. The current value of firm's goodwill was placed at Rs 36,000. Z paid Rs 50,000 by way of his capital. He also paid an appropriate amount for his share of goodwill. X and Y wrote off the goodwill account before Z's admission.

Pass the necessary journal entries.

Z`s share of goodwill =Rs 36000*1/3=Rs 12000

Old profit sharing ratio beteen X andY = 5:4

New profit sharing ratio amoungX,Yand Z 1:1:1

Sacrificed by X 5/9 – 1/3=2/9

Sacrificed by Y 4/9—1/3=1/9

Ratio sacrificed by Xand Y =2/9:1/9 or 2:1

Hence ,Xget the credit of Rs 12000*2/3= Rs 8000 and Ygets the credit of Rs 12000*1/3=Rs 4000

Journal

Date	Particulars	LF	Amount(Rs)	Amount(Rs)
1.4.2017	X capital Account ------------------Dr Y capital Account ------------------Dr To goodwill Account		10000 8000	18000
1.4.2017	Bank Account ----------------------Dr Z`s capital account		62000	62000

Illustration:Ram and Mohan were partness in a firm sharing profits in the ratio of 4 : 1. On 01-03-2005 they admitted Sohan as a new partner for 1/3rd share in the profits of the firm. They fixed the new profit sharing ratio as 4 : 2 : 3.

On the date of Sohan's admission, the firm had a joint life policy Rs. 60,000 (surrender value 20,000). The profit & loss account on the date of admission showed a balance of Rs. 32,000 (Dr.). The firm also had a Reserve of Rs. 1,00,000.

Sohan is to bring Rs. 60,000 as premium for his share of goodwill.

Showing your calculations clearly, pass necessary journal entries to record the above.

SOLUTION :

Journal

		Rs.	Rs.
Revaluation A/c (JLF) Dr.		20,000	
To Ram's Capital A/c			16,000
To Mohan's Capital A/c			4,000
(For profit on revaluation due to increase in the value of asset transferred to old partners a/cs in 4 : 1)			
Ram's Capital A/c Dr.		25,600	
Mohan's Capital A/c Dr.		6,400	
To Profit & Loss A/c Dr.			32,000
(For the transfer of loss to old partness capital a/cs in the ratio of 4 : 1)			
Reserve A/c Dr.		1,00,000	
To Ram's Capital A/c			80,000
To Mohan's Capital A/c			20,000
(For transfer of reserve to old partness capital a/cs in the ratio of 4 : 1)			
Bank A/c Dr.		60,000	
To Premium for Goodwill A/c			60,000
(For amount of goodwill brought in by new partner)			
Premium for Goodwill A/c Dr.		60,000	
Mohan's capital A/c		4,000[2]	
To Ram's Capital A/c			64,000
(For partners' share of goodwill adjusted mutually)			

Note: (1) Sacrificing ratio = Old ratio - New ratio

Ram = (4)/5-4/9=(36-20)/45=16/45 sacrifice

Mohan = 1/5-2/9=(9-10)/45=(1/45)Gain

(2) Mohan's share of goodwill = Rs. 60,000 x 9/3 ×1/45 = Rs. 4,000

Illustration: X and Y are partners in a firm sharing profits and losses equally. They admit Z as a partner for 1/5th share of profits. Z brings into partnership book debts amounting to Rs. 1,00,000 (less provision for bad and doubtful debts of 5%), the goodwill of his

Connections valued at Rs. 2,00,000 and the balance amount in cash which is borrowed from his friend W, so as to make his capital equal to Rs. 6,00,000. The goodwill of the old firm (X and Y) is to be taken at Rs. 3,00,000.

Show journal entries in the books of the firm assuming that the partners do not like to continue goodwill account in their books.

Solution:

Journal

			Rs.	Rs.
	Sundry Debtors A/c Dr.		1,00,000	
	Goodwill A/c Dr.		2,00,000	
	Bank A/c (Balancing figure) Dr.		3,05,000[1]	
	To Provision for Bad & Doubtful Debts A/c			5,000
	To Z's Capital A/c			6,00,000
	(For amount of capital brought by. Z in the form of assets & cash)			
	Z's Capital A/c Dr.		60,000	
	To X's Capital A/c			30,000
	To Y's Capital A/c			30,000
	(For C's share of goodwill Rs. 60,000 (Rs. 3,00,000 x 1/5) credited to old partners capital a/cs in their sacrificing ratio of 1 : 1)			
	X's Capital A/c Dr.		80,000	
	Y's Capital A/c Dr.		80,000	
	Z's Capital A/c Dr.		40,000	
	To Goodwill A/c			2,00,000[2]
	(For goodwill written off debited to all partners capital accounts in their new ratio of 2 : 2 : 1)			

(1) Note:CashRs. 3,05,000 = Rs. 6,00,000 (capital) — Rs. 95,000 (book-debts) i.e. Rs. 1,00,000 ¬Rs. 5,000 — Rs., 2,00,000 (goodwill)

(2) Calculation of new profit sharing ratio : Let total profit = 1; Balance of profit = 1 — 1/5 = 4/5

A 1/2 of 4/5 = 4/10; B 1/2 of 4/5 = 4/10

A: B: C = 4/10 : 4/10 : 1/5= 2 : 2 : 1

Illustration: Ram and Mohan were partness in a firm sharing profits in the ratio of 4 : 1. On 01-03-2005 they admitted Sohan as a new partner for 1/3rd share in the profits of the firm. They fixed the new profit sharing ratio as 4 : 2 : 3.

On the date of Sohan's admission, the firm had a joint life policy Rs. 60,000 (surrender value 20,000). The profit & loss account on the date of admission showed a balance of Rs. 32,000 (Dr.). The firm also had a Reserve of Rs. 1,00,000.

Sohan is to bring Rs. 60,000 as premium for his share of goodwill.

Showing your calculations clearly, pass necessary journal entries to record the above.

Solution:

Journal

Date	Particulars		L.F.	Rs.	Rs.
	Revaluation A/c (JLF)	Dr.		20,000	
	To Ram's Capital A/c				16,000
	To Mohan's Capital A/c				4,000
	(For profit on revaluation due to increase in the value of asset transferred to old partners a/cs in 4 : 1)				
	Ram's Capital A/c	Dr.		25,600	
	Mohan's Capital A/c	Dr.		6,400	
	To Profit & Loss A/c	Dr.			32,000
	(For the transfer of loss to old partners' capital a/cs in the ratio of 4 : 1)				
	Reserve A/c	Dr.		1,00,000	
	To Ram's Capital A/c				80,000
	To Mohan's Capital A/c				20,000
	(For transfer of reserve to old partners' capital a/cs in the ratio of 4 : 1)				
	Bank A/c	Dr.		60,000	
	To Premium for Goodwill A/c				60,000
	(For amount of goodwill brought in by new partner)				
	Premium for Goodwill A/c	Dr.		60,000	
	Mohan's Capital A/c			4,000[2]	
	To Ram's Capital A/c				64,000
	(For partners' share of goodwill adjusted mutually)				

Note: (1) Sacrificing ratio = Old ratio — New ratio
Ram =4/5 –4/9 =(36 –20)/45sacrifice made
Mohan = 1/5 –2/9 =(9 -10)/45 = (1/45)Being a negative result it is a gain
(2) Mohan's share of goodwill = Rs. 60,000 x 9/3x1/45 = Rs. 4,000

Illustration: Rose and Daisy carried on a business in partnership sharing profits and losses in the ratio of 3 : 1. Their Balance Sheet as on 31.3.1994 was as under:

	Liabilities	Rs.	Assets		Rs.
Creditors		93,750	Land and Buildings		62,500
General		10,000	Furniture		2,500
Capital :			Debtors	41,250	
Rose	75,000		*Less : Provision*	1,250	40,000
Daisy	40,000	1,15,000	Bills Receivable		7,500
			Stock		50,000
			Cash at Bank		56,250
		2,18,750			2,18,750

Lily was admitted as a partner on 1st April, 1994, on the following terms

(i) She was to bring in Rs. 35,000 as her capital for 1/5th share in the profits.

(ii) Goodwill of the firm was valued at Rs. 1,00,000. Lily was to bring half of her share of goodwill in cash and the other half was unable to bring in cash.

(iii) Stock and Furniture were to be reduced in value by 10% and the provision for doubtful debts was to be brought up to 10% of the debtors.

(iv) The value of Land and Buildings was appreciated by 25%.

(v) Creditors include an amount of Rs. 5,000 received as commission from Pinky. The necessary adjustment is required to be made.

You are required to prepare the necessary accounts and the balance sheet of the newly constituted firm.

Solution.

Profit & Loss Adjustment Account

			Rs.		Rs.
To Stock A/c			5,000	By Land & Building	15,625
To Furniture A/c			250	By Creditors A/c	5,000
To Provision for Doubtful Debts (4,125 - 1,250)			2,875		
		Total (Dr.)	8,125	Total (Cr.)	20,625
To Capital A/cs (Profits) :					
Rose	3/4	9,375			
Daisy	1/4	3,125			
			12,500		
			20,625		20,625

Partners' Capital Accounts

	Rose	Daisy	Lily	Particulars	Rose	Daisy	Lily
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To Rose's Capital A/c	-	-	7,500	By Balance b/d	75,000	40,000	-
To Daisy's Capital A/c	-	-	2,500	By General Reserve	7,500	2,500	-
To Balance c/d	1,06,875	50,625	25,000	By P/L Adjustment A/c	9,375	3,125	-
				By Bank A/c	-	-	35,000
				By Premium for Goodwill A/c	7,500	2,500	-
				By Lily's Capital A/c	7,500	2,500	-
	1,06,875	50,625	35,000		1,06,875	50,625	35,000

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Creditors		88,750	Land & Buildings		78,125
Capital A/cs :			Furniture		2,250
Rose	1,06,875		Debtors	41,250	
Daisy	50,625		*Less :* Provision	4,125	37,125
Lily	25,000	1,82,50	Bills Receivable		7,500
			Stock		45,000
			Cash at Bank (Rs. 56,250+ Rs. 10,000 +35,000)		1,01,250
		2,71,25			2,71,250

Note :Lily's share of goodwill = 1,00,000 x 1/5 = Rs. 20,000. Lily brings half of her share of goodwill in cash.

Illustration: (Hidden Goodwill) Rajesh and Ravi are partners sharing profits in the ratio of 3 : 2. Their Balance Sheet stood as under:

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Creditors		38,500	Cash		2,000
Bank Loan		4,000	Stock		15,000
Capital A/cs :	Rs.		Prepaid		1,500
Rajesh	29,000		Debtors	9,400	
Ravi	15,000	44,000	*Less :*	400	9,000
			Machinery		19,000
			Building		35,000
			Furniture		5,000
		86,500			86,500

Ramanis admitted as a new partner introducing a capital Rs. 16,000. The firm pays off the bank loan, such amount being credited to Rajesh Loan Account. The new profit sharing ratio is decided as 5 : 3 : 2. Raman is unable to bring in any cash for goodwill which is calculated on the basis of Raman's share in the profits and the capital contributed by him. Following revaluations are made :

(i) Stock to depreciate 5%
(ii) Provision for doubtful debts is to be Rs. 500
(iii) Furniture to depreciate 10%
(iv) Buildings are valued at Rs. 40,000

Show the necessary ledger accounts and the balance sheet of the new firm.

Solution.

Revaluation Account

				Rs.		Rs.
To Stock A/c				750	B	5,000
To Provision for Doubtful Debts A/c				100		
To Furniture A/c				500		
To Profit transferred to Capital A/cs :		Rs.				
	Rajesh	3/5	2,190			
				3,650		
	Ravi	2/5	1,460			
				5,000		5,000

Partners' Capital Accounts

Parti	Rajesh	Ravi	Rama	Particulars	Rajesh	Ravi	Rama
	Rs.	Rs.	Rs.		Rs.	Rs.	Rs.
To				By Balance b/d	29,000	15,000	-
(Cap				By Revaluation A/c	2,190	1,460	-
adjus	31,190	16,460	16,000	By Cash A/c	-	-	16,000
	31,190	16,460	16,000		31,190	16,460	16,000
To Rajesh's	--	--	1,635				
To Ravis	--	--	1,635				
To Balance	32,825	18,095	12,730	By Balance b/d	31,190	16,460	16,000
				By Raman Capital A /c[1]	1,635	1,635	
	32,825	18,095	16,000		32,825	18,095	16,000

Balance Sheet

Liabilities		Rs.	Assets		Rs.
Creditors		38,500	Cash (Rs. 2,000 + Rs. 16,000 + 4,000 - 4,000)		18,000
Rajesh's Loan		4,000	Stock		14,250
Capital A/cs :	Rs.		Prepaid Insurance		1,500
Rajesh	32,825		Debtors	9,400	
Ravi	18,095		*Less :* Provision for Doubtful Debts	(500)	8,900
Raman	12,730	63,650	Machinery		19,000
			Building		40,000
			Furniture		4,500
		1,06,150			1,06,150

Note: (1) Calculation of Hidden Goodwill :

For 2/10th share; Raman contributes = Rs. 16,000

Hence full capital of the new firm = 16,000 x 10/2 = Rs. 80,000

But combined capital of all three partners after adjustments : = Rs. 31,190 + Rs. 16,460 + Rs. 16,000 = Rs. 63,650 Therefore goodwill is Rs. 16,350 (Rs. 80,000 - Rs. 63,650)

(2) Raman will be debited by his share of goodwill Rs. 3,270 i.e. 16,350 x 2/10 and Rajesh and Ravi will be credited in their sacrificing ratio i.e. equally

(3)Bank Loan paid off by loan taken from Rajesh. The entries will be :

(i) Cash A/c Dr. 4,000

To Rajesh's Loan 4,000

(ii) Bank's Loan Dr. 4,000

To Cash A/c 4,000

Let's sum up:

Admission of a partner is one of the modes of the reconstitution of the firm under which old partnership comes to an end and the new partnership begins between all the partners including the incoming partner. Indian Partnership Act states that a new partner can be admitted only when the existing partners give their free consent for the same. So, when the existing partners of a firm permit a new person to join as their new partner, is called admission of the new partner. A new partner is admitted when the firm needs additional capital or managerial help or both for the expansion of the business.

Key terms:

Charge against profit: It is the deduction from revenue to ascertain net profit or net loss.
Capital account: it is a general ledger account used for recording the amounts an investor pays to the company and the cumulative amount of the company's earnings minus cumulative distributions to the owners.
Current account: is prepared when capital is fixed. Transactions such as drawings, salary, and interest on capital and drawings are recorded.
Partner's Drawings: Partner's drawings generally refer to amounts withdrawn by partners from the partnership business in anticipation of their share of profits for meeting their private or domestic expenses.
Interest on Drawings: Sometimes interest is not only allowed on capitals but is also charged on drawings. In such case
Fixed Capital method: Under this method the capital invested by the partners remains constant unless additional capital is brought in or some part of the existing capital is withdrawn permanently by agreement.
Fluctuating Capital Account: Under this method only one account is maintained i.e. Capital account. It records all transaction relating to drawings, interest on drawings, interest on capital account, salary, commission, profit or loss share etc are recorded in the capital accounts.
Appropriation of profit: The net profit of the partnership business is to be shared by all the partners in the agreed profit sharing ratio.
Profit and loss account: it is an account that shows the quantum of surplus funds available to the entity at the end of a financial period.
Profit and loss appropriation account: gives the details about how the surplus that is shown in the profit and loss account is going to be spent.

Self-Assessment Questions.

Problem 1.: A and B are partners sharing profits as to A 3/4 and B 1/4. The capitals are A Rs 90,000 and B Rs 30,000. It is decided that with effect from 1st April, 2010 the profit-sharing ratio will be: A 5/8 and B 3/8. The partnership deed states that goodwill is to be valued at 2 years' purchase of three years' profits and those capitals of the two partners should be proportionate to the profit-sharing ratio. The profits for the years ended 31st March, 2008, 31st March, 2009 and 31st March, 2010 were Rs 42,000, Rs 39,000 and Rs 45,000 respectively. Make necessary journal entries.

Problem 2.: M and N are partners sharing profits and losses in the ratio 3:2 respectively. They admit C as partner who is unable to bring goodwill in cash but pays Rs 96,000 as his capital. The goodwill of the firm is to be valued at two years' purchase of three years' profits. The profits for the three years were Rs 30,000, Rs 24,000 and 27,000. An adjustment entry is to be passed for C's share of goodwill. The new ratio will be 5 : 2 : 2.