



CHAPTER – 2

Quick Revision Notes

ACCOUNTING FOR PARTNERSHIP FIRMS: DISTRIBUTION OF PROFITS

Rules Applicable in the Absence of Partnership Deed

In the absence of partnership deed, the relevant provisions of the Indian Partnership Act, 1932 shall become applicable which are as follows:

- (i) The partners shall share firm's profits or losses equally
- (ii) If any partner has given some loan to the firm, he is entitled to take interest on such loan @ 6 % p.a.
- (iii) No interest is allowed to partners on the capital invested by them.
- (iv) No interest will be charged on drawings made by the partners.
- (v) No partner is entitled to get remuneration such as salary, commission etc. for participating in the business of the firm.

Main journal Entries for preparing Profit & Loss Appropriation Account

For preparing the Profit & Loss Appropriation Account, the following journal entries have to be passed for various items:

(a) Transfer the balance of P/L A/c to P/L Appropriation A/c :

- (i) If Profit and Loss A/c shows a credit balance (or net profit) :

Profit & Loss A/c	Dr.
To Profit & Loss Appropriation A/c	Dr.
- (ii) If Profit and Loss A/c shows a debit balance (or net loss) :

Profit & Loss Appropriation A/c	Dr.
To Profit & Loss A/c	

(b) For interest on capital :

- (i) Interest on Capital A/c

To Partner's Capital/Current A/c s (Individually)	Dr.
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- (ii) Profit & Loss Appropriation A/c

To Interest on Capital A/c	Dr.
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(c) For partner's remuneration :

- (i) Partner's Salary/Commission/Bonus A/c

To Partner's Capital/Current A/c s (Individually)	Dr.
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- (ii) Profit & Loss Appropriation A/c

To Partner's Salary/Commission/Bonus A/c	Dr.
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(d) For interest on drawings :

- (i) Partner's Capital/Current A/c s (Individually)

To Interest on Drawings A/c	Dr.
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- (ii) Interest on Drawings A/c

To Profit & Loss Appropriation A/c	Dr.
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- (e) For transfer to reserve :
 Profit & Loss Appropriation Dr.
 To Reserve A/c
- (f) For transfer of partner's share of profit or loss after appropriations :**
- (i) If divisible profit (credit side is bigger) :
 Profit & Loss Appropriation A/c Dr.
 To Partner's Capital/Current A/cs (Individually)
- OR
- (ii) If divisible loss (debit side is bigger) :
 Partner's Capital/Current A/cs (Individually) Dr.
 To Profit & Loss Appropriation A/c

Format of Profit & Loss Appropriation A/c

Profit & Loss Appropriation A/c

Dr. for the year ended Cr.

Particulars	Rs.	Particulars	Rs.
To Interest on Partners' Capital A/c	By Profit & Loss A/c (Net Profit)	.....
To Partners' Salary A/c	By Interest on Drawings A/c	.....
To Partners' Commission A/c		
To Reserve A/c	By Partners' Capital or Current A/	
To Partners' Capital or Current A/cs :		cs :	
(Divisible Profit)	-----	(Divisible Loss)	.....

- Note:** (i) Divisible profit transferred to Partners' Capital Account in case of Fluctuating Capital method.
- (ii) Divisible profit transferred to Partners' Current Account in case of Fixed Capital method.

Format of Fixed Capital Account

Dr. Partners' Capital A/c Cr.

Particulars	Rs.	Particulars	Rs.
To Cash/Bank A/c (if permanent withdrawal of capital)	By Cash/Bank A/c (If capital is contributed initially), or	.....
To Balance c/d (Closing Balance)	By Balance b/d	.....
(Difference between the two sides)	(If there is old credit balance of capital a/c)	
		By Cash/Bank A/c	.....
Total	Total	.....



Dr.		Partners' Current A/c		Cr.	
Particulars	Rs.	Particulars	Rs.		
To Balance b/d (In case of debit balance)	By Balance b/d (In case of credit balance)	.....	
To Drawings A/c	By Interest on Capital A/c	.....	
To Interest on Drawings A/c	By Salary A/c	.....	
To Profit & Loss Appropriation A/c (Share of Loss)	By Commission/Bonus A/c	.....	
To Balance c/d (Closing Balance) (Difference between the two sides)	By Profit & Loss Appropriation A/c (Share of Profit)	.....	
Total	Total	.....	

Format of Fluctuating Capital Account

Dr.		Partners' Capital A/c		Cr.	
Particulars	Rs.	Particulars	Rs.		
To Balance b/d (In case of debit balance)	By Cash A/c	.....	
To Drawings A/c	Balance b/d (In case of credit balance)	.....	
To Interest on Drawings A/c	By Interest on Capital A/c	.....	
To Profit & Loss Appropriation A/c (Share of Loss)	By Salary A/c	.....	
To Cash A/c	By Commission/Bonus A/c	.....	
To Balance c/d (Closing Balance) (Difference between the two sides)	By Profit & Loss Appropriation A/c (Share of Profit)	.....	
Total	Total	.....	

Commission on Net Divisible Profits payable to Manager/Partner

- (i) On net/divisible profits **before** charging such commission will be calculated as follows :

$$\text{Commission} = \text{Net/Divisible Profit} \times \text{Rate}/100$$

- (ii) On net/divisible profits **after** charging such commission will be calculated as follows :

$$\text{Commission} = \text{Net/Divisible Profit} \times \text{Rate}/100 + \text{Rate}$$

Calculation of Interest on Drawings

1. **When dates of drawings are not given :**

- (i) **Average period method :**

Formula

$$\text{Interest on Drawings} = \text{Total Drawings} \times \text{Rate} / 100 \times 6/12$$

- (ii) **Average rate of interest method or when drawings are made irrespective of time period :**

Formula



$$\text{Interest on Drawings} = \text{Total Drawings} \times \frac{\text{Average Rate}}{100}$$

2. When dates of drawings are given :

(i) Product method :

Formula

$$\text{Interest} = \text{Total of Product} \times \frac{\text{Rate}}{100} \times \frac{1}{365} \text{ or } \frac{1}{12}$$

(ii) Monthly/quarterly drawings method :

Formula

$$\text{Average Time Period} = \frac{\text{Time period of Ist Drawing} + \text{Time period of Last Drawing}}{2}$$

OR

Average Time period = (Months left after first drawing + Months left after last drawing)/2

Points to be Remember

1. Interest on Partner's Loan – When a partner provides a loan to a firm, it is credited to his loan A/c and not included in his Capital A/c. A partner is entitled to interest on loan whether the firm has earned profit or not. Interest on partner's loan being a charge against the profits, is transferred to the debit of the Profit & loss A/c and not to the debit of the Profit & Loss Appropriation A/c.
2. Past Adjustments - At the time of preparation of final A/cs , it is found that few omissions or error have occurred. These may be in respect of interest on capital, interest on drawings, partner's salary, distribution of profits among partners etc. These errors can be corrected by passing a single adjustment entry through partners' capital A/c. In order to make an adjusting entry following steps should be taken into consideration:
 - i. Prepare a correct Profit & Loss Appropriation A/c.
 - ii. Now calculated amount credited to each partner by adding his share of interest on capital, salary, profit and subtracting interest on drawings.
 - iii. Calculate total of amount to be credited of each partner's capital or current A/c.
 - iv. Divide the profit among the partners in their profit sharing ratio.
 - v. Now find out the balance of each partner separately(Debit or Credit).
 - vi. Pass journal entry.