Partnership: Fundamentals

Guarantee of profits

An assurance is given to a partner that a <u>minimum amount</u> is given to him irrespective of profits

The firm or the partner who has given the guarantee is DEBITED

The partner to whom guarantee has been given is CREDITED.

This guarantee can be given in any one of the following forms----

(Guarantee of minimum profits to a partner by firm)

A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1 with a guarantee of minimum profits to C for ` 15,000. Total profits of the firm for the year ended on December 31, 2012 amounted ` 60,000. Prepare a profit and loss appropriation account to show the distribution of profits as per terms of partnership deed.

When Guarantee of minimum profit to a partner is given by the firm, we can solve the question in two different methods.

METHOD 1-----<u>Out of total profits of 60,000, C has been credited with 15,000(guaranteed amount)and the balance of profit distributed among A and B in their profit sharing ratio</u>

Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. **Cr.**

Particulars	`	Particulars	`
To A's Capital A/c (3/5 of ` 45,000)	27,000	By Profit and Loss A/c (Net Profits)	60,000
To B's Capital A/c (2/5 of ` 45,000)	18,000		
To C's Capital A/c (1/6 of ` 60,000 or `15,000 whichever is more)	15,000		
	60,000		60,000
	-------------		------------

QB365 - Question Bank Software

METHOD 2

C has been credited for 10,000 by the firm &

C has been credited with 5,000 by debiting A and B in their profit sharing ratio

Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. **Cr.**

Particulars	`	Particulars	`
To A's Capital A/c (3/6 of ` 60,000) 30,000 Less: Deficiency Borne for C (3,000) -------	27,000	By Profit and Loss A/c (Net Profits)	60,000
To B's Capital A/c (2/6 of ` 60,000) 20,000 Less: Deficiency Borne for C (2,000) -------	18,000		
To C's Capital A/c (1/6 of ` 60,000 10,000 Add: Deficiency Recovered from A 3,000 Add: Deficiency Recovered from B 2,000 -------	15,000		
	60,000 ------------		60,000 ------------

➢ **Working Note:**

Minimum guarantee to C = `15,000

Less: C's actual share in profits = ` 10,000

Deficiency in profits = ` 15,000 - ` 10,000 = **5,000**

This deficiency will be borne by A and B in their profits sharing ratio i.e., 3:2.

(Guarantee of minimum profits to a partner by other partners in a specific ratio)

1. A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1 with a guarantee of minimum profits to C for ˆ 15,000. Total profits of the firm for the year

ended on December 31, 2012 amounted ˆ60,000. Any excess payable to C on account of such guarantee shall be borne by A and B in equal ratio.

Prepare a profit and loss appropriation account to show the distribution of profits as per terms of partnership deed.

Solution----

C has been credited by debiting firm for 10,000 &

C has been credited by debiting A and B in specific ratio , i.e, equal

Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. **Cr.**

Particulars	`	**Particulars**	`
To A's Capital A/c **(3/6 of ` 60,000) 30,000** **Less: Deficiency** **Borne for C (2,500)** **-------**	**27,500**	**By Profit and Loss A/c** **(Net Profits)**	**60,000**
To B's Capital A/c **(2/6 of ` 60,000)** **20,000** **Less: Deficiency** **Borne for C (2,500)** **-------**	**17,500**		
To C's Capital A/c **(1/6 of ˆ 60,000** **10,000** **Add: Deficiency** **Recovered from A 2,500** **Add: Deficiency** **Recovered from B 2,500** **-------**	**15,000**		
	60,000 **-------------**		**60,000** **------------**

❖ **Working Note:**

Minimum guarantee to C = ˆ15,000

Less: C's actual share in profits = ˆ 10,000

Deficiency in profits = ˆ 15,000 - ˆ 10,000 = ˆ 5,000

This deficiency will be borne by A and B in **equal ratio i.e., 1:1.**

(Guarantee of minimum profits to a partner by other partner – one partner only)

A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1 with a guarantee of minimum profits to C for ˆ 15,000. Total profits of the firm for the year ended on December 31, 2012 amounted ˆ60,000. Any excess payable to C on account of such guarantee shall be borne by A.

Prepare a profit and loss appropriation account to show the distribution of profits as per terms of partnership deed.

C has been credited by debiting firm for 10,000 &

C has been credited by debiting A only for 5,000

Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. Cr.

Particulars	ˆ	Particulars	ˆ
To A's Capital A/c (3/6 of ˆ 60,000) 30,000 Less: Deficiency Borne for C (5,000) -------	25,000	By Profit and Loss A/c (Net Profits)	60,000
To B's Capital A/c (2/6 of ˆ 60,000)	20,000		
To C's Capital A/c (1/6 of ˆ 60,000) 10,000 Add: Deficiency Recovered from A 5,000 -------	15,000		
	60,000		60,000
	-------------		------------

2. A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1 with a guarantee of minimum profits to C for ˆ 15,000. Total profits of the firm for the year ended on December 31, 2012 amounted ˆ60,000. Any excess payable to C on account of such guarantee shall be borne by B.

Prepare a profit and loss appropriation account to show the distribution of profits as per terms of partnership deed.

C has been credited by debiting firm for 10,000 &

C has been credited by debiting B only for 5,000

SOLUTION:

Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. Cr.

Particulars	ˆ	Particulars	ˆ
To A's Capital A/c (3/6 of ˆ 60,000)	30.000	By Profit and Loss A/c (Net Profits)	60,000
To B's Capital A/c (2/6 of ˆ 60,000) 20,000 Less: Deficiency Borne for C (5,000) -------	15,000		
To C's Capital A/c (1/6 of ˆ 60,000 10,000 Add: Deficiency Recovered from B 5,000 -------	15,000		
	60,000 -------------		60,000 ------------

❖ **Working Note:**

Minimum guarantee to C = ˆ15,000

Less: C's actual share in profits = ˆ 10,000

Deficiency in profits = ˆ 15,000 - ˆ 10,000 = ˆ 5,000

In 4 question deficiency will be borne by <u>A only</u>

<u>In 5 question deficiency to borne by B only</u>

(Guarantee of minimum profits to firm by partners)

3. A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1. The partnership deed provided the following:

1. Interest on Capital is to be provided @ 10% p.a.
2. Interest on drawings is to be charged @ 12% p.a.
3. Salary payable to C ˆ 2,000 per month.
4. C had guaranteed that the firm would earn a profits of ˆ 1,20,000 before charging or allowing interest and salary payable to partners.

Capital of A,B, and C at the beginning of the year were ˆ 1,00,000, ˆ 80,000 and ˆ 60,000 respectively. Drawings of the partners during the year ended on 31st March, 2012 were A: ˆ 20,000, B: ˆ 15,000 and c: ˆ 10,000.

The actual profits before interest and salary amounted to ˆ 1,10,000.

Prepare Profit and Loss Appropriation Account for the year ending on 31st March, 2012. .
Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. Cr.

Particulars	ˆ	Particulars	ˆ
To Interest on Capital: (@ 10% p.a.) A 10,000 B 8,000 C 6,000 -------	24.000	By Profit and Loss A/c (Net Profits) By C's Capital A/c	1,10,000 10,000
To Salary to C (ˆ 2,000 X 12)	24,000	By Interest on Drawings: (@12% p.a. for 6 months as the date of drawings is not given) A 1,200 B 900 C 600	2,700
To Profits transferred to Capital A/cs of: A 37,350 B 24,900 C 12,450	74,700		
	1,22,700		1,22,700

- **Note: Firm's profit is ˆ 1,10,000 (i.e., ˆ 10,000 less than the amount guaranteed by C) .**
- **As such ˆ 10,000 will be debited to C's Capital A/c and credited to Profit and Loss Appropriation A/c.**

(Actual amount of profit is more than the guaranteed amount)

1. A, B and C are partners in a firm sharing profits and losses in the ratio of 3:2:1 with a guarantee of minimum profits to C for ˆ 15,000. Total profits of the firm for the year ended on December 31, 2012 amounted ˆ1,20,000. Any excess payable to C on account of such guarantee shall be borne by B.

Prepare a profit and loss appropriation account to show the distribution of profits as per terms of partnership deed. Profit and Loss Appropriation Account

For the year ending on 31ST March, 2012

Dr. Cr.

Particulars	`	Particulars	`
To A's Capital A/c (3/6 of ` 1,20,000)	60.000	By Profit and Loss A/c (Net Profits)	1,20,000
To B's Capital A/c (2/6 of ` 1,20,000)	40,000		
To C's Capital A/c (1/6 of ` 1,20,000 or `15,000 whichever is higher)	20,000		
	1,20,000		1,20,000

❖ **Working note**

Share of Actual profits=20,000

Guaranteed amount=15,000

Values Involved in above questions-

- **Financial Security,**
- **Mutual Understanding,**
- **Team Spirit.**
- **Transparency**

Questions regarding Past Adjustment

Q.7 Asha, Bela and Cheena were sharing profits equally. Their capitals were ` 40,000; ` 20,000 and ` 30,000 respectively. After closing the accounts for the year 2004, it was found that the interest on capital @ 10% p.a. was not allowed before distributing the profits. It was decided to pass a single adjusting entry to rectify the accounts of the year 2004. Journalise. (CBSE 2005)

Solution 7:

Journal

Date	Particulars	L.F.	Dr.(`)	Cr.(`)
2005 Jan.1	Bela's capital A/c Dr. To Asha's capital A/c (adjustment of interest on capital for the year 2004)		1,000	1,000

Working Note:

	Asha	Bela	Cheena	Total
Interest on capital Cr.	4,000	2,000	3,000	9,000
Profit to be recovered Dr.	3,000	3,000	3,000	9,000
Adjustment	1,000	1,000	---	---
	Cr.	Dr.	---	---

Q.8 A, B, C and D are partners sharing profits & Losses in the ratio of 4:3:3:2. Their respective fixed capitals on March 31,2010 were ` 60,000, ` 90,000, ` 1,20,000 and ` 90,000. After preparing the final accounts for the year ended March 31,2010, it was discovered that interest on capital @ 12% p.a. was not allowed and interest on drawings amounting to ` 2,000, ` 2,500, ` 1,500 and ` 1,000 respectively was also not charged.

Pass the necessary adjustment Journal entry showing your workings clearly.

(CBSE 2011)

Solution 8:

Journal

Date	Particulars	L.F.	Dr.(`)	Cr.(`)
2010 Apr.1	A's current A/c Dr. B's current A/c Dr. To C's current A/c To D's current A/c (Adjustment of interest on capital and interest on drawings for the year 2009-10)		6,867 750	 3,850 3,767

Working Note:

	A	B	C	D	Total
Interest on capital Cr.	7,200	10,800	14,400	10,800	43,200
Interest on drawings Dr.	2,000	2,500	1,500	1,000	7,000
Profit to be recovered Dr.	12,067	9,050	9,050	6,033	36,200
Total Dr.	14,067	11,550	10,550	7,033	
Adjustment	6,867	750	3,850	3,767	
	Dr.	Dr.	Cr.	Cr.	

Q.9 Ram, Shyam and Mohan are partners in a firm sharing profits and losses in the ratio of 2:1:2. Their fixed capitals were ` 3,00,000, ` 1,00,000 and ` 2,00,000 respectively. Interest on capital for the year 1996 was credited to them @ 9% p.a. instead of 10% p.a.. Showing your working notes clearly, pass necessary adjusting Journal entry.

Solution 9:

Journal

Date	Particulars	L.F.	Dr.(`)	Cr.(`)
1997 Jan.1	Shyam's current A/c Dr. Mohan's current A/c Dr. To Ram's current A/c (adjustment of interest on capital for the year 1996)		200 400	 600

Working Note:

	Ram	Shyam	Mohan	Total
1% Interest on capital Cr.	3,000	1,000	2,000	6,000
Profit to be recovered Dr.	2,400	1,200	2,400	6,000
Adjustment	600 Cr.	200 Dr.	400	

Q.10 Mohan, Vijay and Anil are equal partners, the balances in their capital accounts being ` 30,000, ` 25,000 and ` 20,000 respectively. In arriving at these figures, the profits for the year ended December 31,1992 are ` 24,000 had already been credited to partners in the proportion in which they shared profits. Their drawings were:

Mohan ` 5,000, Vijay ` 4,000 and Anil ` 3,000 in 1992.

Subsequently, the following omissions were noticed and it was decided to bring them into account.

(i) Interest on capital @ 10% p.a.
(ii) Interest on Drawings: Mohan ` 250, Vijay ` 200and Anil ` 150.

Make the necessary rectifications through a Journal entry and show your workings clearly. (CBSE 1994)

Solution 10:

Calculation of Opening Capital

	Mohan	Vijay	Anil
Closing capital	30,000	25,000	20,000
Add: Drawings	5,000	4,000	3,000
	35,000	29,000	23,000
Less: Profit already distributed	8,000	8,000	8,000
Opening capital	27,000	21,000	15,000
Interest on capital @ 10% p.a.	2,700	2,100	1,500

Table Showing Adjustment

		Mohan	Vijay	Anil	Total
Interest on capital	Cr.	2,700	2,100	1,500	6,300
Interest on drawings	Dr.	250	200	150	600
Profit to be recovered	Dr.	1,900	1,900	1,900	5,700

Total Adjustment	Dr.	2,150 550 Cr.	2,100 ---	2,050 550 Dr.	6,300

Journal

Date	Particulars	L.F.	Dr.(`)	Cr.(`)
1993 Jan.1	Anil's capital A/c Dr. To Mohan's capital A/c (adjustment of interest on capital and interest on drawings for the year 1992)		550	 550

Q.11 X, Y and Z are partners in a firm who share profits in the ratio of 2:3:5. The firm earned a profit of ` 1,50,000 for the year ended December 31,2004. The profit by mistake was distributed among X, Y and Z in the ratio of 3:2:1 respectively. This error was noted only in the beginning of the next year.

Pass necessary Journal entry to rectify the error. (CBSE 2005)

Solution 11:

Table Showing Adjustment

		X	Y	Z	Total
Profit already distributed	Cr.	75,000	50,000	25,000	1,50,000
Profit to be distributed	Dr.	30,000	45,000	75,000	1,50,000
Adjustment		45,000 Dr.	5,000 Dr.	50,000 Cr.	

Journal

Date	Particulars	L.F.	Dr.(`)	Cr.(`)
2005 Jan.1	X's capital A/c Dr. Y's capital A/c Dr. To Z's capital A/c (adjustment of profit sharing ratio for the year 2004)		45,000 5,000	 50,000

Values Involved in questions of past adjustments:

- **Admitting errors committed**
- **Rectifying those errors**
- **Communicating the correct information**

Reconstitution of Partnership: Change in Profit Sharing Ratio

Q.12 P, Q and R are partners sharing profits equally. They decided that in future R will get 1/5 share in profits and remaining profit will be shared by P and Q equally. On the day of change, firm's goodwill is valued at ` 60,000. Give Journal entries arising on account of change in profit- sharing ratio. Also identify the value involves in adjustment of goodwill.

Solution 12:

Value involves: Reward for sacrifice
Change in share of:
P = 1/3-2/5 = 5-6/15 = - 1/15 (Gain)
Q = 1/3-2/5 = 5-6/15 = - 1/15 (Gain)
R = 1/3-1/5 = 5-3/15 = 2/15 (Sacrifice)

Journal

Date	Particulars	L.F.	Dr.(`)	Cr.(`)
	P's capital A/c Dr. Q's capital A/c Dr. To R's capital A/c (adjustment of goodwill for change in profit sharing ratio)		2,000 2,000	 4,000

Reconstitution of Partnership: Death of a Partner

Q.13 G, H and I were partners in a firm sharing profits in the ratio of 4:3:3. On March 31, 2006, their Balance Sheet was as follows:

Balance Sheet

As at March 31, 2006

Liabilities		`	Assets	`
Creditors		87,000	Buildings	1,70,000
Reserve		33,000	Machinery	1,20,000
Capitals			Stock	40,000
G	1,05,000		Debtors	45,000
H	85,000		Cash	15,000
I	80,000	2,70,000		
		3,90,000		3,90,000

H died on June 30,2006. Under the partnership agreement, the executors of a deceased partner were entitled to:

(i) Amount standing to the credit of deceased [partner's capital account at the time of death.
(ii) Interest on capital @ 12% per annum,
(iii) His share of goodwill. The goodwill of the firm on H's death was valued at ` 2,70,000.
(iv) His share in the profit till the date of the death on the basis of last year's profit. The profit of the firm for the year ended on March 31, 2006 was ` 2,40,000.

Identify the value involves in the calculation of share of profit of deceased partner.
Prepare H's capital account to be rendered to his executors.

Solution

. H's Capital Account

Particulars	`	Particulars	`
To H's Executor A/c	1,96,450	By balance b/d	85,000
		By interest on capital	2,550
		By G's capital A/c	46,286
		By I's capital A/c	34,714
		By P&L suspense A/c	18,000
		By reserve	9,900
	1,96,450		1,96,450

Value involved in questions of Reconstitution of Partnership

Adapting to changes
Integrity
Justification
Transparency