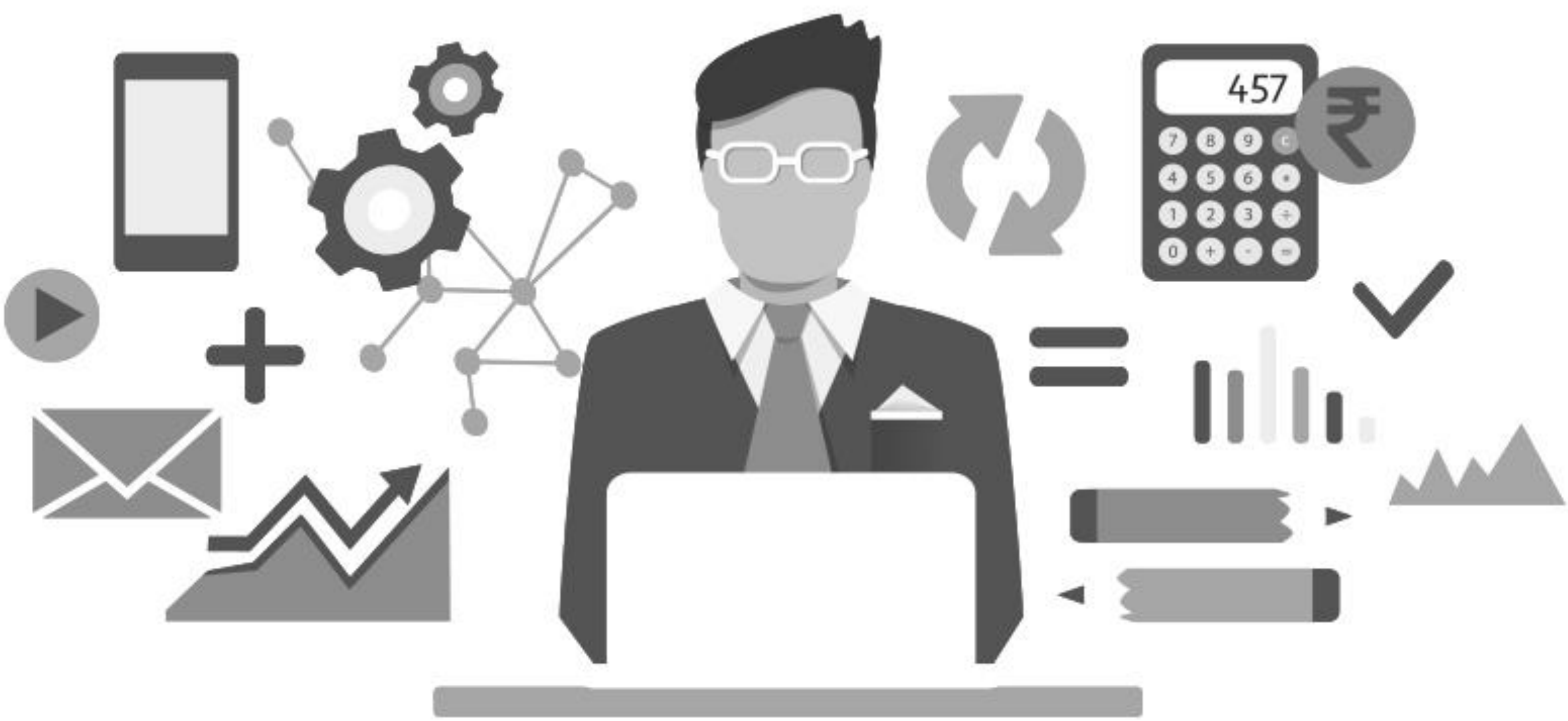
ACCOUNTANCY



Accounting for Partnership: Basic Concepts

Meaning and Definition of Partnership

- **Meaning**
  - Partnership is an association between two or more persons who agree to do business and share its profits and losses.
  - Partnership is a business relationship among two or more persons to share profits and losses of the business, carried on by all or any of them acting for all.

- **Definition:**
  - Partnership is defined by Indian Partnership Act, 1932, Section 4 as follows: "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

Essential Features or Characteristics of Partnership:

Following are the essential features or characteristics of partnership:

i. **Two or more persons:** To form a partnership, there must be at least 2 partners who are competent to contract and who are not minor, persons of unsound mind and persons disqualified by any law. The maximum number of the partners in the firm cannot exceed 50 vide Rule 10 of the Companies Rules, 2014 as prescribed by the Central Government.

ii. **Agreement:** It is a legal document signed by all the partners. A written agreement containing the terms and conditions of partnership and because of which the partnership comes into existence is known as Partnership Deed.

iii. **Lawful Business:** A partnership is formed to do a lawful business which includes trade, vocation and profession. Any type of charitable institution running as a not-for-profit organization will not be considered as a business.

iv. **Profit-Sharing:** A partnership agreement specifies how the profits and losses of the firm will be shared by the partners.

v. **Business can be carried on by all or any of the Partners Acting for All:** Since, the partners are the agents as well as principals of the firm, such business of the partnership firm can be carried on by all or any of the partners acting for all.

Rights of Partners:

Every Partner has the right:

i. to participate in the management of the business.
ii. to be consulted about the affairs of the business.
iii. to inspect the books of account and have a copy of it.
iv. to share profits and losses with others in the agreed ratio.
v. to receive interest on the loan advanced by him to the firm at an agreed rate of interest. Where the rate is not agreed, interest is paid at the rate of 6% p.a. as per the provisions of Indian Partnership Act, 1932.
vi. to act according to his best judgment in case of emergency and be indemnified for the expenses incurred by him.
vii. not to allow the admission of a new partner.
viii. to retire from the firm after giving proper notice for the same.
ix. to get indemnified against the expenses incurred by him on the business or incurred by him on behalf of the firm.

Partnership Deed:

A written document containing the terms and conditions of partnership and because of which the partnership comes into existence is known as Partnership Deed. It is a legal document signed by all the partners and has the following clauses:

i. **Description of the Partners:** It contains names, description and addresses of the partners.
ii. **Description of the Firm:** It contains name and address of the firm.
iii. **Principal Place of Business:** It contains address of the principal place of business.
iv. **Nature of Business:** It specifies the nature of business that the firm shall carry on.
v. **Commencement of Partnership:** Date of commencement of partnership is specified in this clause.
vi. **Capital Contribution:** It mentions the amount of capital that each partner contributes whether capital accounts are fixed or fluctuating.
vii. **Interest on Capital:** It specifies the interest on capital if such interest is allowed to be paid.
viii. **Interest on Drawings:** It specifies the rate of interest on drawings if such interest is charged on drawings.
ix. **Profit-Sharing Ratio:** It specifies the ratio in which the profits and losses of the firm are shared by the partners.
x. **Interest on Loan:** It specifies the rate of interest paid on the loan by the partner to the firm.
xi. **Remuneration to Partners:** It specifies the amounts of salary, commission, etc. payable to the partners.
xii. **Valuation of Goodwill:** It specifies the method by which the goodwill of the firm will be valued in the event of reconstitution of the partnership.
xiii. **Valuation of Assets:** It specifies the manner in which assets of the firm shall be valued in the event of reconstitution of the partnership.
xiv. **Settlement of Accounts:** It specifies the manner in which the accounts of the partner(s) shall be settled in case of partners' retirement or death or in the event of dissolution of the firm.
xv. **Accounting Period:** It specifies the date on which accounts of the firm are closed every year.
xvi. **Rights and Duties of Partners:** It specifies the rights and duties of the partners.

xvii. **Duration of Partnership:** It specifies whether the partnership is for a specified period or for a venture or at will.
xviii. **Bank Account Operation:** It specifies how the bank accounts should be operated; whether by any of the partners or jointly by all partners.
xix. **Death of a Partner:** It specifies whether the firm will continue or dissolve in the event of death of a partner.
xx. **Settlement of Disputes:** It specifies how the disputes among the partners shall be settled, if any arises.

Importance of Partnership Deed:

i. An important legal document.
ii. Defines relationship between the partners.
iii. Governs the rights, duties and liabilities of each partner and therefore, avoids and settles possible disputes among the partners.
iv. In case of any dispute among partners, partnership deed is considered as the basis for settlement of such dispute.
v. Not essential but desirable to have a Partnership Deed
vi. Where there is no partnership deed, provisions of Indian Partnership Act, 192 will be applied.

Provisions Affecting Accounting Treatment in the Absence of Partnership Deed:

Provisions of the Indian Partnership Act, 1932 shall be applicable when there is no Partnership Deed or if the Partnership Deed is silent. Following are the matters for which provisions of this Act shall be applicable, if the partnership deed is silent on the same:

i. **Sharing of Profits/Losses:** Profits/Losses are shared equally by the partners.
ii. **Interest on Capital:** No such interest on capital is allowed to partners.
iii. **Interest on Drawings:** No such interest on drawings is charged from partners.
iv. **Interest on Advance/Loan by a Partner:** Interest shall be paid at the rate of 6%p.a. Such interest shall be payable even if there is a loss from business as it is a charge against profit.
v. **Remuneration to Partners:** No partner shall be paid such remuneration as salary, commission, etc. if the partnership deed is silent on such matter.
vi. **Liabilities of Partners:** Subject to agreement among the partners:
    a. **Profit from a similar business:** In case if a partner earns profit from a business that is similar to that of the firm in competition with the firm, then such profit earned from such business shall be paid to the firm.
    b. **Profit earned for self from firm's business:** In case if the partner earns profit for self from any business transaction of the firm or from the use of firm's property or business connection, the profit so earned shall be paid to the firm.

Important Provisions of the Indian Partnership Act, 1932:

i. **Section 30:** A minor may be admitted for the benefit of partnership if all the partners agree.
ii. **Section 31:** A person may be admitted as a partner either with the consent of all the existing partners or in accordance with an express agreement among the partners.
iii. **Section 32:** A partner may retire from the firm either with the consent of all the other partners or in accordance with an express agreement among the partners.
iv. **Section 69:** Registration of the firm is optional and not compulsory.
v. **Section 35**: Unless otherwise agreed by the partners in the Partnership Deed, a firm is dissolved on the death of a partner.

Limited Liability Partnership (LLP):

- **Meaning:** An LLP is a corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership.

- **Characteristics:**
    i. **Separate Legal Entity:** An LLP has a separate legal entity and therefore, LLP and its partners are distinct from each other.
    ii. **Minimum Capital:** Such minimum capital of an LLP is not specified and therefore, the partners of the LLP decide how much capital will be contributed by each partner.
    iii. **Minimum Number of Members:** A minimum of 2 members are required to establish an LLP who shall also be the Designated Partners and shall have Director Identification Number (DIN). There is no limit on the maximum number of partners.
    iv. **Audit is not mandatory:** Audit of an LLP is not compulsory except for the following:
        a. If the contributions of the LLP exceeds Rs.25lakhs or
        b. If the annual turnover of the LLP exceeds Rs.40lakhs.

Interest on Partner's Loan to the firm:

- **Meaning:**
    i. It is the interest payable by the firm to the partner for the loan given by the partner to the firm.
    ii. The rate of interest on partners' loan is specified in the Partnership Deed.
    iii. If the Partnership Deed is silent, interest shall be paid @6%p.a. on loan.

- **Accounting Treatment:** Journal Entries passed are as follows:
    i. **To provide Interest on Partners' Loan:**
    Interest on Partner's Loan A/c …Dr.
    To Partners' Loan A/c
    ii. **To close the Interest on Partners' Loan A/c:**
    Profit and Loss A/c …Dr.
    To Interest on Partners' Loan A/c

Distribution of Profit among Partners:

Profit of the firm is distributed among the Partners through the Profit and Loss Appropriation Account. It is important to understand the meaning and the specimen of such Profit and Loss Appropriation Account explained as follows:

- **Meaning of Profit and Loss Appropriation Account:** Such Profit and Loss Appropriation Account is an extension of the Profit and Loss Account and therefore, the credit balance of the Profit and Loss Account is transferred to Profit and Loss Appropriation Account. Such amount is then utilized for the following:
  i. interest on the capitals of partners, if provided by the partnership deed;
  ii. salaries or commissions to partners, if provided by the partnership deed;
  iii. Transferring part of profit to Reserve;
  iv. Distribution of profit among the partners in their profit sharing ratio.

- **Specimen of Profit and Loss Appropriation Account:**

Profit and Loss Appropriation Account
Dr. for the year ended … Cr.

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

*In case of Fluctuating Capital Method, Profit will be transferred to Partners' Capital Accounts. In case of Fixed Capital Method, Profit will be transferred to Partners' Current Accounts.

Difference between Profit and Loss Account and Profit and Loss Appropriation Account:

	Basis	Profit and Loss Account	Profit and Loss Appropriation Account
1	**Stage of Preparation**	It is prepared after Trading Account and therefore, starts with Gross Profit or Gross Loss transferred from the Trading Account.	It is prepared after Profit and Loss Account and therefore, starts with Net Profit or Net Loss as transferred from the Profit and Loss Account.
2	**Objective**	It determines net profit earned or net loss incurred during the accounting year.	It shows appropriation of net profit i.e., distribution of Net Profit for the accounting period among the partners.
3	**Nature of Items**	It is debited with the expenses and credited with the income, not being business income to determine net profit for accounting period.	It is debited with the items of appropriation of profit like salary, commission, interest on capital, transfer to reserve, etc. and credited with the items of income being debited to Partners' Capital Account or Current Accounts such as interest on drawings.
4	**Partnership Deed**	This account is not guided by the Partnership Deed or Agreement.	This account is prepared as guided by the Partnership Deed or Agreement or provisions of Indian Partnership Act, 1932.
5	**Matching Principle**	It follows the Matching Principle where revenue is matched against expense.	It does not follow the Matching Principle.

Ratio of Appropriation when the Appropriations are more than Available Profit:

In case where the total amount of appropriations is more than the amount of profit available, profit available for distribution among the partners is distributed in the ratio of appropriation to be made. The ratio of such appropriation is determined as follows:

i. Calculate the amount of appropriation payable to each partner as per the Partnership Deed (ignoring the profit available for distribution among partners) like the salary, commission and interest on capital, etc.
ii. Calculate the total amount of appropriation (as per step (i) above) for each partner separately.
iii. Calculate the ratio of the Appropriations (as per step (ii) above) to be made to each partner.
iv. Lastly, ratio calculated in (iii) above shall be the ratio in which available profits shall be distributed among the partners.
v. It is important to note that no particular item like salary, commission, interest on capital, etc., has priority over other items of appropriation.

Special Aspects of Partnership Accounts:

Following are some of the issues that require special treatment at the time of preparing the financial statements of the firm.

- **Partners' Capital Accounts:** In a partnership firm, separate Capital Accounts are maintained for each partner as each of the partners is the owner and has separate transactions with the firm. These Partners' Capital Accounts can be maintained by following any of the 2 methods:
  i. **Fixed Capital Accounts Method:** In this method, the capital amount invested by each of the partner in the firm remains fixed or unaltered, unless a partner introduces additional capital or withdraws out of his or her capital. Such fixed capital is recorded in the Capital Account and for recording all transactions other than transactions related to capital such as drawings, interest on capital, interest on drawings, salary, commission, share of profit/losses, etc. Current Accounts are maintained in addition to the Capital Accounts.
  Specimen for the 2 accounts maintained under Fixed Capital Method is as follows:

Dr. Partners' Capital Accounts Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Cash/Bank A/c (Drawings against Capital)	…	…	…	By Balance b/d	…	…	…
To Balance c/d	…	…	…	By Cash/Bank A/c (Additional Capital)	…	…	...
	…	…	…		…	…	…

Dr. Partners' Current Account Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Balance b/d (In case of debit opening balance)	…	…	…	By Balance b/d (In case of credit opening balance)	…	…	…
To Drawings A/c (Drawings against Profit)	…	…	…	By Interest on Capital A/c	…	…	…
To Interest on Drawings A/c	…	…	…	By Commission A/c	…	…	…
To Profit and Loss A/c (Loss)	…	…	…	By Partners' Salary A/c	…	…	…
To Balance c/d*	…	…	…	By Profit and Loss App. A/c (Profit)	…	…	…
	…	…	…		…	…	…

*Such balance may be on the opposite (credit) side also.

  ii. **Fluctuating Capital Accounts Method:** In this method, only one account is maintained which is the Capital Account. All the transactions related to the addition or withdrawal of capital, salary, commission, interest on capital, interest on drawings, share of profits or losses, etc. are recorded in this Capital Account only. This method is followed for maintaining Capital Accounts and therefore, in the absence of any instructions, this method should be followed for maintaining the Partners' Capital Accounts.

Specimen for the account maintained under Fluctuating Capital Method is same as follows:

Dr. Partners' Capital Accounts Cr.

Particulars	X	Y	Z	Particulars	X	Y	Z
To Balance b/d (In case of debit opening balance)	…	…	…	By Balance b/d (In case of credit opening balance)	…	…	…
To Cash/Bank A/c (Drawings against Capital)	…	…	…	By Cash/Bank A/c (Additional Capital)	…	…	…
To Drawings A/c (Drawings against Profit)	…	…	…	By Interest on Capital A/c	…	…	…
To Interest on Drawings A/c	…	…	…	By Commission A/c	…	…	…
To Profit and Loss A/c (Loss)	…	…	…	By Partner's Salary A/c	…	…	…
To Balance c/d*	…	…	…	By Profit and Loss App. A/c (profit)	…	…	…
	…	…	…		…	…	…

***The balance may be on the opposite (credit) side also.**

- **Salary or Commission (Remuneration) to Partners:**
  - i. In order to compensate the partners for looking after the business, the firm pays salary or commission to the partners.
  - ii. Such salary or commission can be allowed to the partners only if the Partnership Deed allows it to be paid.
  - iii. Such amount paid to the partners is an appropriation of profit and not a charge against the profit. Therefore, it can be paid only if the firm is making profits during the year.
  - iv. Salary to partners is normally stated as an amount, whereas, Commission to partners is normally stated as a percentage of profit where the profit considered can be either before commission or after commission.
  - v. Formula for computing commission under the 2 methods is as follows:
    - a. Percentage of Net Profit before charging Commission:

$$\text{Net Profit }(\text{before commission})\times \textit{Rate of commission}\div 100$$

    - b. Percentage of Net Profit after charging Commission:

$$\text{Net Profit (before commission)}\times\text{Rate of Commission}\div(100+\text{Rate of Commission})$$

  - vi. Accounting treatment: Salary or Commission, is an appropriation of profit, therefore, accounting treatment will be as follows:
    - a. On allowing Salaries/Commissions to Partners:

      Partners' Salaries/Commissions A/c …Dr.

      To Partners' Current A/cs (when capitals are fixed)

      To Partners' Capital A/cs (when capitals are fluctuating)

b. On closure of Salaries/Commissions A/cs:
Profit and Loss Appropriation A/c …Dr.
To Partners' Salaries/ Commissions A/c

- **Interest on Partners' Drawings:**
  i. Drawings are the amounts that are withdrawn, in cash or in kind, by partners for their personal use.
  ii. These drawings can be out of capital or profits. When the amount withdrawn is a part of capital, it is referred to as drawings out of capital. While drawings out of profits are the amounts withdrawn against profit earned during the year.
  iii. If the Partnership Deed provides for charging interest on such amounts withdrawn by the partners against profits, such interest is termed as interest on drawings.
  iv. It is important to note that such interest is not charged on the drawings that are made against capital.
  v. Such Interest charged on Drawings is credited to the Profit and Loss Appropriation Account and debited to Partners' Capital Accounts or Partners' Current Accounts.
  vi. Calculation of such interest is to be done taking into consideration the time from the date of withdrawal till the end of the financial year.

- **Methods of Calculating Interest on Drawings:** There are 2 methods of calculating interest on drawings which are explained as follows:
  a. Product Method: This method is used when drawings of same amount or different amounts are withdrawn at irregular intervals. Again this method can be used in 2 ways namely, as simple method and product method.
    i. **Simple Method:** In this method, interest is calculated on each single drawing amount. For such calculation, period for which the amount has been utilised is to be considered.
    ii. **Product Method:** In this method, amount of drawings is multiplied with the number of months or number of days it has been used. After this, the product so obtained is totaled and the interest is calculated thereon for one month (when period is considered in months) or for 1 day (when period is considered in days). Formula is as follows:

    $Interest = \left[Total\ of\ \text{product} \times \left(Rate\ of\ \text{Interest} \div 100\right) \times \left(1 \div 12\right)\right]$, in case period is in terms of months,

    $Interest = \left[Total\ of\ \text{product} \times \left(Rate\ of\ \text{Interest} \div 100\right) \times \left(1 \div 365\right)\right]$, in case period is in terms of days

  b. Average Period Method: Interest on drawings is calculated using this method when:
    a. there are regular drawings or
    b. the amount of drawings is uniform and the time interval between the 2 drawings is uniform.
    Formula is as follows:

    $Interest = \left[Total\ drawings \times \left(Rate\ of\ \text{Interest} \div 100\right) \times \left(Average\ \text{Period} \div 12\right)\right]$, where

    $Average\ \text{Period} = \left(Months\ left\ after\ fisrt\ drawings + Months\ left\ after\ last\ drawings\right) \div 2$

- **Journal Entries to record interest on drawings are as follows:**
  i. **In case of Fixed Capital Accounts:**
    a. Partners' Current A/cs …Dr.
    To Interest on Drawings A/c
    (Being the interest charged on partners' drawings)

b. Interest on Drawings A/c ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest on drawings transferred to Profit and Loss Appropriation A/c)

Alternatively: only one entry can be passed in place of above 2 entries as follows:

Partners' Current A/cs ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest charged on drawings of partners)

ii. **In case of Fluctuating Capital Accounts**:

a. Partners' Capital A/cs ...Dr.
To Interest on Drawings A/c
(Being interest charged on partners' drawings)

b. Interest on Drawings A/c ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest on drawings transferred to Profit and Loss Appropriation A/c)

Alternatively: only one entry can be passed in place of above 2 entries as follows:

Partners' Capital A/cs ...Dr.
To Profit and Loss Appropriation A/c
(Being the interest charged on drawings of partners)

- **Points to remember for calculating interest on drawings under different circumstances:**

Sr. no.	Circumstances	Calculation of Interest
1	If amount of drawings are drawn at the beginning of every month.	Interest is charged on the whole amount for 6 and a half (6.5) months at an agreed rate per annum.
2	If amount of drawings is drawn as a fixed sum in the middle of every month.	Interest is charged on the whole amount for 6 months at an agreed rate per annum.
3	If amount of drawings is drawn as a fixed sum at the end of every month.	Interest is charged on the whole amount for 5 and a half (5.5) months at an agreed rate per annum.
4	If amount of drawings is drawn as fixed sum in the beginning of each quarter.	Interest is charged on the whole amount for a period of 7 and a half (7.5) months at an agreed rate per annum.
5	If the partner withdraws a fixed sum in the middle of each quarter.	Interest is charged on the whole amount for a period of 6 months at an agreed rate per annum.
6	If the partner withdraws a fixed sum at the end of each quarter.	Interest is charged on the whole amount for a period of 4 and a half (4.5) months at an agreed rate per annum.
7	If the partner withdraws unequal amount on different dates.	Interest is calculated using simple method or product method.
8	If dates of drawings are given and the interest is to be charged at an agreed rate per annum.	Interest is calculated on the basis of time.
9	If the date of withdrawal is not given.	Interest on total drawings for the year is calculated for six months on the average basis.

10	If the rate of interest is given without the word 'per annum.'	Interest is charged without considering the time factor.

- **Interest on Partners' Capitals:**
  i. In order to compensate a partner for contributing capital to the firm in excess of the profit-sharing ratio, firm pays such interest on partner's capital.
  ii. In case any amount is contributed by the partner to the firm in the form of additional capital during the year, interest on such additional capital is allowed for the period it has remained in business.
  iii. In case if any amount of capital is withdrawn by the partner during the year, no interest is allowed on the capital amount withdrawn.

- **Important provisions relating to Interest on Capital:**
  i. **If there is no Partnership Deed or there is no clause in the deed as to interest on capital:** Interest on Capital is not allowed.
  ii. **If the Partnership Deed provides for interest on capital but is silent as to the treatment of interest as a charge or appropriation:** Interest on capital is treated as appropriation of profit. Such interest is payable only if the firm is making profits. Following are possible situations:
    a. In case of loss: No interest is allowed.
    b. In case of profit, where profit before interest is equal to or more than the interest: Interest is allowed at the agreed rate.
    c. In case of profit, where profit before interest is less than the interest: Interest is allowed only to the extent of profit in the ratio of interest on capital of each partner.
  iii. **If the Partnership Deed provides for interest as a charge (i.e., to be allowed whether there are profits or loss):** Interest on capital is allowed whether there is profit or loss.

- **Journal Entries for recording Interest on Capital:**
  i. In case of Fixed Capital Accounts:
    a. Interest on Capital A/c ...Dr.
       To Partners' Current A/cs
       (Being the interest on capital allowed to partners)
    b. Profit and Loss Appropriation A/c ...Dr.
       To Interest on Capital A/cs
       (Being the interest on capital transferred to Profit and Loss Appropriation Account)

  Alternatively: only one entry can be passed in place of above 2 entries as follows:
  Profit and Loss Appropriation A/c ...Dr.
  To Partners' Current A/c
  (Being the interest on capital allowed to partners)

  ii. In case of Fluctuating Capital Accounts:
    c. Interest on Capital A/c ...Dr.
       To Partners' Capital A/cs
       (Being the interest allowed on partners' capitals)
    d. Profit and Loss Appropriation A/c ...Dr.
       To Interest on Capital A/cs
       (Being the interest on capital transferred to Profit and Loss Appropriation Account)

  Alternatively: only one entry can be passed in place of above 2 entries as follows:
  Profit and Loss Appropriation A/c ...Dr.
  To Partners' Capital A/c
  (Being the interest on capital allowed on partners' capitals)

- **Calculation of Interest on Opening Capital:**
  - **i.** In case where the partner has not withdrawn capital or has not introduced additional capital during the year, closing balance of Capital Account of the previous year is the opening balance in the Capital Account.
  - **ii.** Interest on Capital is allowed on the Opening Capital of the partner.
  - **iii.** If the opening capital is not given, it can be determined by preparing Capital Accounts or with the help of following tables:

a. In case of Fixed Capital:

Calculation of Opening Capital

Capital at the end of the year Add: Withdrawal of Capital	… …
 Less: Additional Capital Introduced during the year	… …
Capital in the beginning of the year	…

b. In case of Fluctuating Capital:

Calculation of Opening Capital

Capital at the end of the year Add: Drawings Against Capital Drawings Against Profit Interest on Drawings Share of Loss for the year*	… … … … …
 Less: Additional Capital introduced during the year Partner's Salary/Remuneration Interest on Capital Share of Profit for the year*	… … … … …
Capital in the beginning of the year	…

***** Either loss or profit will appear at a time.

Past Adjustments (Adjustments for incorrect adjustments in past after closing the books):

It is possible that even after the books of accounts of the partnership firm are closed, some errors and omissions still exist. Such errors and omissions are to be rectified by adjusting the Capital Accounts of the affected partners by:

I. **passing an adjustment entry:** Here, a single adjustment entry is passed for the net amount of all past adjustment. An analytical table can be prepared for determining net effect of the past adjustments and passing the adjustment entry.

II. **passing adjustment entries:** Here, separate entry is to be passed for every adjustment. In this case, analytical table to determine the net effect is not prepared. Entries are passed for each and every error or omission by debiting or crediting Profit and Loss Adjustment Account which is then closed by debiting or crediting with the corresponding credit or debit to the Partners' Current Accounts or Capital Accounts.

Accounting Entries to be passed when separate adjustment entries are passed through Profit and Loss Adjustment Account:

i. **Entry for the items which are to be credited to the Partners' Capital/Current Accounts:**
   Profit and Loss Adjustment A/c ...Dr.
   To Partners' Capital/Current A/cs
   (Being the adjustment made for previously omitted, now recorded)

ii. **Entry for the items which are to be debited to the Partners' Capital/Current Accounts:**
   Partners' Capital/Current A/cs ...Dr.
   To Profit and Loss Adjustment A/c
   (Being the adjustment made for previously omitted, now recorded)

iii. **Entry for Net Profit/Loss due to above adjustments:**
   a. **For Profit:**
   Profit and Loss Adjustments A/c ...Dr.
   To Partners' Capital/Current A/cs
   (Being the profit on adjustment credited to Partners' Capital/Current Accounts)
   b. **For Loss:**
   Partners' Capital/Current A/cs ...Dr.
   To Profit and Loss Adjustment A/c
   (Being the loss on adjustment transferred to Partners' Capital/Current Accounts)

Accounting Treatment when a manager is admitted as Partner with Retrospective Effect:

If at any time partners of the firm decide to admit the Manager as a partner with retrospective effect, profits for those years, interest paid on loan, etc. is to be adjusted to give effect to the terms of partnership. This can be done by passing either a single adjustment entry or by passing separate entries for each adjustment. Net effect of these adjustments can be determined with the help of following steps:

Step 1. Calculate the amount paid as remuneration to the Manager.
Step 2. Calculate the amount which should be allowed to the Manager on becoming a partner.
Step 3. Compare the amounts calculated in step 1 and step 2. If the amount in step 2 is more, it is credited to his account and debited to old partners in their old profit sharing ratio. If the amount in step 1 is more, it is debited to his account and credited to Old Partners' Capital Accounts, in their old profit sharing ratio.

Guarantee of Profit:

At the time of admission of a partner, it is possible that the new partner is admitted in the firm with minimum guaranteed profits from the business. It means that the guaranteed partner shall get the minimum guaranteed profit even if the guaranteed partner's or new partner's share of profit is less than the guaranteed amount.
When profit is guaranteed to an existing or incoming partner, it can be done in 2 ways as follows:

i. Profit may be guaranteed by all the remaining partners in an agreed ratio: In this case, following steps are followed :
   Step 1: Share of profit as per profit sharing ratio is determined, and
   Step 2: Minimum guaranteed profit is determined.
   Step 3: Higher of the above two amounts (in step 1 and step 2) is given to the guaranteed partner.
   Step 4: If the share of profit is less than the guaranteed amount, the difference in the amount of profit (i.e., minimum guaranteed profit – share of profit of the guaranteed partner) is borne by the remaining partners in the agreed ratio and where the agreed ratio is not given such difference is borne by the partners in their profit sharing ratio.
ii. Profit may be guaranteed by one or more of the existing or old partners: In this case, following steps are to be followed:
   Step 1: Amount of profit is to be distributed among the partners as per their profit sharing ratio.
   Step 2: In case share of profit of the guaranteed partner is less than the minimum guaranteed profit, the difference is deducted from the share of profit of the partner or partners who has guaranteed and it is added to the share of profit of the guaranteed partner.
   Step 3: When two or more partners guarantee, the shortfall (deficiency) is shared by them in the agreed ratio or in their profit sharing ratio as the case may be.

Accounting treatment of Guarantee of minimum profit to a partner in case of Loss:

In case where the firm is incurring losses and minimum guaranteed profit is to be paid to the partner who has been guaranteed minimum profit, adjustment will be made through Partners' Capital Accounts as follows:

a) Loss is distributed among the partners in their profit-sharing ratio.
b) Capital Account of the guaranteed partner is credited with the guaranteed minimum profit plus amount of loss.
c) The amount credited to the guaranteed partner's Capital Account is then debited to the remaining partners in their profit sharing ratio or to the debit of the partner who has guaranteed minimum profit.

Minimum earnings guaranteed by a partner:

This is a situation where, a partner (or partners) may guarantee minimum earnings to the firm and/or guarantee a profit to the firm. In such case, any shortfall in earnings is debited to the concerned Partner's (Partners') Capital Accounts or Current Accounts.