

### 2.3 Special Aspects of Partnership Accounts

Accounting treatment for partnership firm is similar to that of a sole proprietorship business with the exception of the following aspects:

- Maintenance of Partners' Capital Accounts;
- Distribution of Profit and Loss among the partners;
- Adjustments for Wrong Appropriation of Profits in the Past;
- Reconstitution of the Partnership Firm; and
- Dissolution of Partnership Firm.

The first three aspects mentioned above have been taken up in the following sections of this chapter. The remaining aspects have been covered in the subsequent chapters.

### 2.4 Maintenance of Capital Accounts of Partners

All transactions relating to partners of the firm are recorded in the books of the firm through their capital accounts. This includes the amount of money brought in as capital, withdrawal of capital, share of profit, interest on capital, interest on drawings, partner's salary, commission to partners, etc.

There are two methods by which the capital accounts of partners can be maintained. These are: (i) fixed capital method, and (ii) fluctuating capital method. The difference between the two lies in whether or not the transactions other than addition/withdrawal of capital are recorded in the capital accounts of the partners.

- (a) Fixed Capital Method: Under the fixed capital method, the capitals of the partners shall remain fixed unless additional capital is introduced or a part of the capital is withdrawn as per the agreement among the partners.

All items like share of profit or loss, interest on capital, drawings, interest on drawings, etc. are recorded in a separate accounts, called Partner's Current Account. The partners' capital accounts will always show a credit balance, which shall remain the same (fixed) year after year unless there is any addition or withdrawal of capital. The partners' current account on the other hand, may show a debit or a credit balance. Thus under this method, two accounts are maintained for each partner viz., capital account and current account. While the partners' capital accounts shall always appear on the liabilities side in the balance sheet, the partners' current account's balance shall be shown on the liabilities side, if they have credit balance and on the assets side, if they have debit balance.

The partner's capital account and the current account under the fixed capital method would appear as shown below:

### Partner's Capital Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Bank (permanent withdrawal of capital)		xxx		Balance b/d (opening balance)		xxx
	Balance c/d (closing balance)		xxx		Bank (fresh capital introduced)		xxx
			xxx				xxx

### Partner's Current Account

Dr.				Cr.			
Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Balance b/d (in case of debit opening bal.)		xxx		Balance b/d (in case of credit opening balance)		xxx
	Drawings		xxx		Salary		xxx
	Interest on drawings		xxx		Commission		xxx
	Profit & Loss a/c		xxx		Interest on capital		xxx
	Balance c/d (in case of credit closing balance)		xxx		Profit & Loss Appropriation (share of profit)		xxx
					Balance c/d (in case of debit closing balance)		xxx
			xxxx				xxxx

Fig. 2.1: Proforma of Partner's Capital and Current Accounts



(b) **Fluctuating Capital Method:** Under the fluctuating capital method, only one account, i.e. capital account is maintained for each partner. All the adjustments such as share of profit and loss, interest on capital, drawings, interest on drawings, salary or commission to partners, etc are recorded directly in the capital accounts of the partners. This makes the balance in the capital account to fluctuate from time to time. That's the reason why this method is called fluctuating capital method. In the absence of any instruction, the capital account should be prepared by this method. The proforma of capital accounts prepared under the fluctuating capital method is given below:

**Partner's Capital Account**

Dr.

Cr.

Date	Particulars	J.F.	Amount (Rs.)	Date	Particulars	J.F.	Amount (Rs.)
	Drawings		xxx		Balance b/d		xxx
	Interest on drawings		xxx		Bank (fresh capital introduced)		xxx
	Profit and Loss A/c (for share of loss)		xxx		Salaries		xxx
	Balance c/d				Interest on capital		xxx
					Profit and Loss Appropriation (for share of profit)		xxx
			xxxx				xxxx

Fig. 2.2: Proforma of Partner's Capital Account under Fluctuating capital Method.

### 2.4.1 Distinction between Fixed and Fluctuating Capital Accounts

The main points of differences between the fixed and fluctuating capital methods can be summed up as follows:

Basis of Distinction	Fixed Capital Account	Fluctuating Capital Account
(i) Number of accounts	Under this method, two separate accounts are maintained for each partner viz. 'capital account' and 'current account'.	Each partner has one account, i.e. capital account, under this method
(ii) Adjustments	All adjustments for drawings, salary, interest on capital, etc. are made in the current accounts and not in the capital accounts.	All adjustments for drawings, salary interest on capital, etc., are made in the capital accounts.
(iii) Fixed balance	The capital account balance remain unchanged unless there is addition to or withdrawal of capital.	The balance of the capital account fluctuates from year to year
(iv) Credit balance	The capital accounts always show a credit balance.	The capital account may sometimes show a debit balance.



## 2.5 Distribution of Profit among Partners

The profits and losses of the firm are distributed among the partners in an agreed ratio. However, if the partnership deed is silent, the firm's profits and losses are to be shared equally by all the partners.

You know that in the case of sole partnership the profit or loss, as ascertained by the profit and loss account is transferred to the capital account of the proprietor. In case of partnership, however, certain adjustments such as interest on drawings, interest on capital, salary to partners, and commission to partners are required to be made. For this purpose, it is customary to prepare a Profit and Loss Appropriation Account of the firm and ascertain the final figure of profit and loss to be distributed among the partners, in their profit sharing ratio.

### 2.5.1 Profit and Loss Appropriation Account

Profit and Loss Appropriation Account is merely an extension of the Profit and Loss Account of the firm. It shows how the profits are appropriated or distributed among the partners. All adjustments in respect of partner's salary, partner's commission, interest on capital, interest on drawings, etc. are made through this account. It starts with the net profit/net loss as per Profit and Loss Account is transferred to this account. The journal entries for preparation of Profit and Loss Appropriation Account and making various adjustments through it are given as follows:

#### Journal Entries

1. Transfer of the balance of Profit and Loss Account to Profit and Loss Appropriation Account:
  - (a) If Profit and Loss Account shows a credit balance (net profit):  
Profit and Loss A/c Dr.  
    To Profit and Loss Appropriation A/c
  - (b) If Profit and Loss Account shows a debit balance (net loss)  
Profit and Loss Appropriation A/c Dr.  
    To Profit and Loss A/c
2. Interest on Capital:
  - (a) For crediting interest on capital to partners' capital account:  
Interest on Capital A/c Dr.  
    To Partner's Capital/Current A/cs (individually)

- (b) For transferring interest on capital to Profit and Loss Appropriation Account:  
 Profit and Loss Appropriation A/c Dr.  
 To Interest on Capital A/c
3. **Interest on Drawings:**
- (a) For charging interest on drawings to partners' capital accounts:  
 Partners Capital/Current A/c's (individually) Dr.  
 To Interest on Drawings A/c
- (b) For transferring interest on drawings to Profit and Loss Appropriation Account:  
 Interest on Drawings A/c Dr.  
 To Profit and Loss Appropriation A/c
4. **Partner's Salary:**
- (a) For crediting partner's salary to partner's capital account:  
 Salary to Partner A/c Dr.  
 To Partner's Capital/Current A/c's (individually)
- (b) For transferring partner's salary to Profit and Loss Appropriation Account:  
 Profit and Loss Appropriation A/c Dr.  
 To Salary to Partner's A/c
5. **Partner's Commission:**
- (a) For crediting commission to a partner, to partner's capital account:  
 Commission to Partner A/c Dr.  
 To Partner's Capital/Current A/c's (individually)
- (b) For transferring commission paid to partners to Profit and Loss Appropriation Account:  
 Profit and Loss Appropriation A/c Dr.  
 To Commission to Partners Capital/Current A/c
6. **Share of Profit or Loss after appropriations:**  
 If Profit:  
 Profit and Loss Appropriation A/c Dr.  
 To Partner's Capital/Current A/c's (individually)

The Proforma of Profit and Loss Appropriation Account is given as follows:

**Profit and Loss Appropriation Account**

Dr.	Amount (Rs.)	Cr.	Amount (Rs.)
Profit and Loss (if there is loss)	xxx	Profit and Loss (if there is profit)	xxx
Interest on Capital	xxx	Interest on Drawings	xxx
Salary to Partner	xxx		xxx
Commission to Partner	xxx		
Interest on Partner's Loan	xxx		
Partners' Capital Accounts (distribution of profit)	xxx		
	<b>xxxx</b>		<b>xxxx</b>

**Fig. 2.3:** Proforma of Profit and Loss Appropriation Account