

Proforma of Profit and Loss Appropriation Account

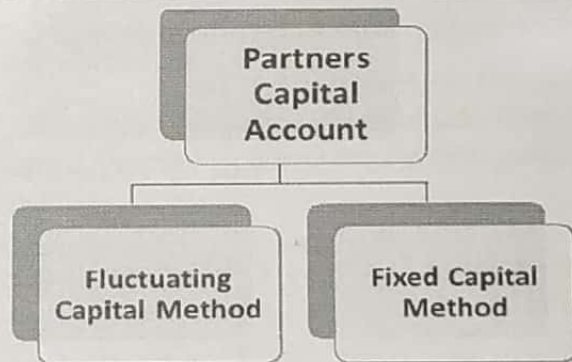
Particulars	Amount	Particulars	Amount
To Interest on Capital		By Profit & Loss A/c (profit)	xxxx
X xxxx		By interest on Drawings :	
Y xxxx		X xxxx	
Z <u>xxxx</u>	xxxx	Y xxxx	
To Partners Salary		Z <u>xxxx</u>	xxxx
X xxxx			
Y xxxx			
Z <u>xxxx</u>	xxxx		
To Partners Commission			
X xxxx			
Y xxxx			
Z <u>xxxx</u>	xxxx		
To Transfer to Reserve	xxxx		
To Profit Transferred to			
X's Capital/Current A/c xxxx			
Y's Capital/Current A/c xxxx			
Z's Capital/Current A/c <u>xxxx</u>	xxxx		
	xxxx		xxxx

Preparation of Partners Capital Accounts

Partner's Capital Accounts : It is an account which represents the partner's interest in the business.

In case of partnership business, a separate capital account is maintained for each partner. The capital accounts of partners may be maintained by following any of the following two methods:

- (1) **Fixed Capital Accounts :** Under this method capitals of the partners remain fixed. Capital accounts of the partners will show always Credit balances. Under This method mainly two



accounts are prepared i.e. Partners Capital Account and Partners Current Account. There are only two situations when fixed capitals of the partners may change :

Situation 1: When Additional Capital is introduced by the partners

Situation 2: When Some part of capital is withdrawn permanently by the partners

Only two items are shown in the credit side i.e. opening balance or capital introduced by the partners and additional capital (if any) introduced by the partners.

In the debit side withdrawn of capital (permanently) and closing balance is shown.

Partners Capital Account

Particulars	A	B	Particulars	A	B
To Cash/bank (withdrawn of capital)	XXXX	XXXX	By Balance b/d	XXXX	XXXX
To balance c/d	XXXX	XXXX			
	XXXX	XXXX		XXXX	XXXX

Partners Current Account

Particulars	A	B	Particulars	A	B
To Cash/bank (withdrawn of capital)	XXXX	XXXX	By Balance b/d	XXXX	XXXX
			By Interest on Capital	XXXX	XXXX
			By Salary/Remuneration	XXXX	XXXX
			By Commission/Bonus	XXXX	XXXX
To balance c/d	XXXX	XXXX	By Balance c/d (if any)	XXXX	XXXX
	XXXX	XXXX		XXXX	XXXX

Note :

1. Debit balance of Current Account is shown in Assets side of Balance Sheet.
2. Credit balance of Current Account is shown in Liabilities side of Balance Sheet.
3. Balance of Capital Accounts are always shown in Liabilities side of Balance Sheet as this account will always show a credit balance when capital is fixed

(2) **Fluctuating Capital Accounts:** Under this method only one account is prepared i.e. Partners Capital Account. It may show Debit or Credit balance.

Credit Side Items :

- (a) Balance of Capital or Capital Introduced by the partners
- (b) Additional Capital (if any) contributed by the partners during the year
- (c) Interest on capital (if any)
- (d) Salary/Remuneration to the partners (if any)
- (e) Commission/Bonus to the partners (if any)
- (f) Share of Profit

Debit Side Items

- (a) Withdrawal of capital (if any)
- (b) Drawings made during the year (if any)
- (c) Interest on drawings (if any)
- (d) Share of loss (if any)
- (e) Closing balance

Partners Capital Account

Particulars	A	B	Particulars	A	B
To Cash/bank (withdrawn of capital)	xxxx	xxxx	By Balance b/d	xxxx	xxxx
To Drawings	xxxx	xxxx	By Cash/Bank (additional cap.)	xxxx	xxxx
To Int. on Drawings	xxxx	xxxx	By Interest on Capital	xxxx	xxxx
To P/L A/c (if loss)	xxxx	xxxx	By Salary/Remuneration	xxxx	xxxx
To balance c/d	xxxx	xxxx	By Commission/Bonus	xxxx	xxxx
			By Balance c/d (if any)	xxxx	xxxx
	xxxx	xxxx		xxxx	xxxx

INTEREST ON CAPITAL

Interest on partners' capital will be allowed only when it has been specifically mentioned in the partnership deed. Interest on Capital can be treated as either an Appropriation of profit or a charge against profits.

Charge	Appropriation
<ul style="list-style-type: none"> ➤ Charge is compulsory in nature. Whether there is profit or loss, all charge items will be met. ➤ Example of Charge: Office Rent Salary to Employees Manager's Commission etc. 	<ul style="list-style-type: none"> ➤ Appropriation is not compulsory in nature. Appropriation is that amount of profit which is paid to the partners in the form of interest on capital, salary, commission/bonus etc. ➤ The concept of appropriation is applicable only when there is some profit. ➤ In case of loss no appropriations. ➤ Example of Appropriation: Interest on capital, salary or remuneration to partners, bonus or commission to partners etc.

A. Interest on Capital : An Appropriation of Profits:

<i>When there is loss</i>	<i>Interest on Capital is not allowed because it is an appropriation and will be paid only when there is some profit</i>
<i>In Case of Sufficient Profits</i>	<i>Interest on Capital is allowed in full. All partners are entitled for the interest on capital at the agreed rate or rate of interest on capital already mentioned in the partnership deed.</i>
<i>In case of Insufficient Profits</i>	<i>Interest on Capital is allowed only to the extent of profits in the ratio of interest on capital of each partner. In this case partners do not get full amount of interest.</i>

B. Interest on Capital: As a Charge against Profits:

Interest on Capital is always allowed in full irrespective of amount of profits or losses

Journal Entries

a. In case of sufficient profits

Profit and Loss Appropriation A/c Dr.
 To Interest on Capital A/c

(Being interest on capital transferred to P & L Appropriation A/c)

b. In case of Insufficient Profits or Losses

Profit and Loss / Profit and Loss Adjustment A/c Dr.
 To Interest on Capital A/c

(Being interest on capital transferred to P&L Adjustment A/c)

Note :

Interest on Capital is always calculated on the opening capital. If Opening Capital is not given in the question, it should be ascertained as follows :

Calculation of Opening Capital

Capital at the end (closing capital)	XXXX
ADD : Drawings made during the year	XXXX
ADD : Share of Loss During the year (if any)	<u>XXXX</u>
	XXXX
Less : Additional Capital introduced (if any)	XXXX
Less : Share of Profit during the year (if any)	<u>XXXX</u>
Capital in the beginning	XXXX

For additional capital interest is calculated for period for which capital is utilised e.g if additional capital is introduced on 1st October in firm where accounts are closed on 31st March.

Interest = Amount introduced x Rate/100 x 6/12 as
money is utilised for 6 months