

CLASSES BY

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**Interest on Capital &
P&L Appropriation A/c**

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INTEREST ON CAPITAL

3 Questions

Ques. 1

From the following BALANCE SHEET of X & Y for the year ended 31st march, 2019, calculate interest on capital @ 10% p.a.

Capital		Sundry assets	295,000
X	150,000	Drawings	
Y	100,000	Y	5,000
P & L Appropriation A/c (31.3.2019)	50,000		
	300,000		300,000

Drawings of X & Y were 10,000 & 5,000 respectively. Profit for the year ended was 60,000

NOTE: Interest on capital is always to be calculated on OPENING CAPITAL.

Here in the question we are given the closing capital. So first we need to ascertain the opening capital.

TREATMENT OF DRAWINGS:

- If they are given outside the balance sheet: That means the capital are NET of drawings. So we need to add the drawings to ascertain the opening capital.
- If they are given in the balance sheet: That means the drawings are not subtracted from the capital and so we don't need to add them back in the capital.

Ans. 1

	X	Y
Closing Capital	150,000	100,000
Less: Profit	5,000	5,000
Add: Drawings	10,000	
Opening capital	155,000	95,000
Interest on capital @10%	15,500	9,500

Ques. 2

From the following balance sheet of X & Y for the year ended 31st march, 2019, calculate interest on capital @ 5% p.a.

Capital		Sundry assets	105,000
X	50,000		
Y	25,000		
P & L Appropriation A/c (31.3.2019)	30,000		
	105,000		105,000

Drawings of X & Y were 10,000 & 5,000 respectively. Profit for the year ended was 60,000; Profit and loss ratio was 3:2

Ans. 2

	X	Y
Closing Capital	50,000	25,000
Less: Profit	18,000	12,000
Add: Drawings	10,000	5,000
Opening capital	42,000	18,000
Interest on capital @5%	2,100	900

Ques. 3

Following is the extract of the Balance Sheet of, Blue and Red as on March 31, 2019

LIABILITIES		ASSETS	
Current Accounts :		Sundry Assets	30,00,000
Blue 1,00,000			
Red 1,00,000	200,000		
Capital Accounts :			
Blue 10,00,000			
Red 10,00,000	20,00,000		
P/L Appropriation (31.3.19)	8,00,000		
	30,00,000		30,00,000

During the year Red's drawings were Rs.30, 000. Profits during 2019 are Rs.10, 00,000.

Calculate interest on capital @ 5% per annum for the year ending March31, 2019.

ANS: 50, 000 EACH

CAPITAL of the partners :-

In order to start or run the firm, partners contribute their share of capital in the business. These are recorded in their respective accounts named as capital accounts.

Suppose there are three partners A, B and C so there will be A's capital A/c, B's capital A/c and C's capital A/c.

All the transactions relating to the partners of the firm are recorded through their respective capital A/c.

The capital A/c of partners may be maintained in two ways:-

FIXED AND FLACTUATING CAPITAL METHOD:

FIXED CAPITAL METHOD:

- Under this method the original capitals invested by the partners remain constant, UNLESS additional capital is introduced or Drawings out of Capital is made.
- All entries relating to drawings, interest on capitals, interest on drawings, salary to partner, share of profits/losses are made in separate account which is called as Current Account.
- This account will always have a credit balance as withdrawals cannot exceed the capital invested.

FLACTUATING CAPITAL METHOD:

- In this method only one account i.e., Capital Account of each and every partner is prepared and all the entries related to partner's capital, drawings etc. are recorded in this account only.
- Under this method, Capital account may show a debit or credit balance and the balance of this account changes frequently from time to time therefore it is called fluctuating Capital Account.

PARTNER'S CAPITAL A/C

Particulars	Amount.	Particulars	Amount.
To Cash/Bank A/c		BY BALANCE B/D	
(Drawings out of capital)			
		By Cash/Bank A/c	
TO BALANCE C/D		(Additional capital)	
	TOTAL		TOTAL

PARTNER'S CURRENT A/C

Particulars	Amount.	Particulars	Amount.
To Drawings (out of Profits)		BY BALANCE B/D	
To Interest on Drawings		By Interest on Capital	
TO BALANCE C/D(B fig.)		By Partner's Salary or Commission	
		By Profit and Loss Appropriation A/c	
	TOTAL		TOTAL

INTEREST ON CAPITAL

Interest on Capital can be treated as either:

AN APPROPRIATION OF PROFITS	OR	AS A CHARGE AGAINST PROFITS:
IN CASE OF LOSSES :-it is not allowed		Interest on Capital is always allowed in full IRRESPECTIVE of amount of profits or losses.
IN CASE OF INSUFFICIENT PROFITS- It is restricted to the amount of profit. Hence, profit will be distributed in the ratio of interest on capital of each partner.		

NOTE:

1. Interest on Capital is always calculated on the OPENING CAPITAL.
2. Interest on Capital is an EXPENSE to the firm and an INCOME to the partner.
3. IN THE ABSENCE of partnership deed: No Interest on Capital is to be allowed to any Partner.

P & L APPROPRIATION A/C

Ques. 1

A & B are partners sharing profits in the ratio 3:2 with capital of 200,000 & 150,000 respectively.

Interest on capital is agreed @5% p.a.

B is to be allowed a monthly salary of 3,000.

The profits for the year **PRIOR** to calculation of interest on capital **BUT AFTER CHARGING SALARY** amounted to 300,000.

A provision of 5% of the profits is to be made in respect of the A's commission.

*The profits for the year **PRIOR** to calculation of interest on capital **BUT AFTER CHARGING SALARY** amounted to 300,000.

This means that we have mistakenly subtracted Salary to partner from the Net profit. We will add this Salary to the profit.

P & L APPROPRIATION A/C

PARTICULARS		AMOUNT	PARTICULARS		AMOUNT
Interest on capital:			NET PROFIT	300,000	
A	10,000		Add: SALARY	36,000	336,000
B	7,500	17,500			
Salary:- B (3000 × 12)		36,000			
Commission:- A (336,000 × 5%)		16,800			
Net profit distributed:-					
A	159,420				
B	106,280	265,700			
		336,000			336,000

Ques. 2

A & B are partners sharing profits in the ratio 3:2.
The firm incurred a loss of 50,000.

Interest on capital amounted to 1,000 & 500 in respect of A & B capital & **interest on B's loan amounted to Rs. 1,500 is yet to be debited from the profits.**

Prepare P & L appropriation account.

P & L A/C				
PARTICULARS		AMOUNT	PARTICULARS	AMOUNT
NET LOSS	50,000		NET LOSS distributed	
Add: INT. ON LOAN	1,500	51,500	A's Capital A/c	30,900
			B's Capital A/c	20,600
		51,500		51,500

Ques. 3

A & B are partners sharing profits in the ratio 3:2.

A being a non-working partner contributes 20,00,000 as capital. B being a working partner agreed to work for the firm.

The partnership deed provides for interest on capital @10% and salary amounted to 20,000 per month to every working partner.

The interest on loan amounted to 10,000 on B's loan is yet to be provided.

Net profit for the year was 340,000.

Prepare P & L appropriation account.

In this Question, **the appropriations are more than the profits**

i.e.

INTEREST ON CAPITAL 200,000

SALARY 240,000

We can't give either the full amount of Interest or the full amount of salary so the distribution should be like that there is no disagreement with the partners.

Here the appropriations are more than the profit which is 330,000 and so we will distribute the net profit in the RATIO OF APPROPRIATION.

RATIO FOR APPROPRIATION 200,000 : 2,40,000 OR 5:6

P & L APPROPRIATION A/C				
PARTICULARS	AMOUNT	PARTICULARS		AMOUNT
Interest on capital:		NET PROFIT	340,000	
A (330,000 *5/11)	150,000	Less: Int. on loan	10,000	330,000
Salary				
B (330,000*6/11)	180,000			
	330,000			330,000

WORKING NOTE:

Here the appropriations are more than the profits and so we will distribute the net profit in the RATIO OF APPROPRIATION.

INTEREST ON CAPITAL 200,000

SALARY 240,000

RATIO FOR APPROPRIATION 20:24 OR 5:6

Ques. 4

X & Y are partners sharing profits in the ratio 5:3. They decided to allow interest on capital @ 10% p.a. Business profits for the year is 10,000. Their capital invested in the business amounted to 300,000 & 150,000 resp. Show the distribution of profits WHEN

#1: There is no agreement except for interest on capital

#2: When there is clear agreement that interest on capital is to be provided **EVEN IF IT INVOLVES THE FIRM A LOSS.**

CASE 1: P & L APPROPRIATION A/C

PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
Interest on capital:		NET PROFIT	10,000
A (10,000 *2/3)	6,667		
B (10,000*1/3)	3,333		
	10,000		10,000

WORKING NOTE:

Here the appropriations are more than the profits and so we will distribute the net profit in the ratio of appropriation

INTEREST ON CAPITAL A 30,000

INTEREST ON CAPITAL B 15,000

RATIO FOR APPROPRIATION 30:15 OR 2:1

CASE 2: P & L APPROPRIATION A/C			
PARTICULARS	AMOUNT	PARTICULARS	AMOUNT
Interest on capital:		NET PROFIT	10,000
A	30,000	NET LOSS distributed	
B	15,000	A	21,875
		B	13,125
	45,000		45,000

(35,000 in 5:3)



Ques. 5

A and B are partners sharing the profits in the ratio of 2 : 3 with capitals of ₹ 1,20,000 and ₹ 60,000 respectively.

On 1st October 2022, A and B gave loans of ₹ 2,40,000 and ₹ 1,20,000 respectively to the firm. A had allowed the firm to use his property for business for a monthly rent of ₹ 5,000. Loss for the year ended 31st March 2023 before rent and interest amounted to ₹ 9,000. Show distribution of profit/Loss.

P & L APPROPRIATION A/C				
PARTICULARS	AMOUNT	PARTICULARS		AMOUNT
Net loss	79,800	NET LOSS distributed		
		A		31,920
		B		47,880
	79,800			79,800

(79,800 in 2:3)

WORKING NOTE:

Net loss = 9,000+ 60,000 (Rent @ 5,000 per month) + Interest on loan of A (240,000 × 6% × 6/12) + Interest on loan of B (120,000 × 6% × 6/12)
 = 9,000 +60,000 +7,200 +3,600 = 79,800