1. Details of Module and its structure

Module Detail	
Subject Name	Accountancy
Course Name	Accountancy 03 (Class XII, Semester - 1)
Module Name/Title	Guarantee of Profit – Part 5
Module Id	leac_10205
Pre-requisites	Knowledge about preparation of Profit and loss Appropriation A/c, Journal Entry of distribution of Profits/Losses Among the Partner
Objectives	After going through this lesson, learners will be able to understand the following: • Accounting treatment of the guarantee given to a partner in case of Insufficient & Sufficient profits. • Accounting treatment of the guarantee given to a partner in case of losses. • Accounting treatment of a guarantee given to a partner including Interest on Capital, Salary/Commission to a partner and share in profits. • Accounting treatment of the guarantee given by a partner to the firm regarding his earnings for the firm.
Keywords	Guarantee; Guarantee of Profit; Guarantee to a Partner

2. Development Team

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1. Guarantee of profit to a partner

Sometimes a partner is given **assurance of certain minimum amount by way of share in the annual profits of the firm**. Such assurance is termed as 'Guarantee to a Partner'.

The partner who gets the guarantee or assurance can be called '**Beneficiary**' and the one who gives guarantee can be called '**Donor**'. Beneficiary could be a newly admitted partner or one of the existing partners.

In the process of distribution of profits, shortage/deficiency to the 'Beneficiary' is computed and compensated. **In the process of compensation, the Beneficiary is credited and Donor(s)/Patron is (are) debited**.

Guarantee can be given by any one partner to another partner individually or by the firm i.e. all the other partners to a particular partner.

For example,

Ojasvi, Samriddhi and Tanuja are partners sharing profits in the ratio 2:2:1. Tanuja was given guarantee that her share in profits will not be less than ₹20,000 in any year. Suppose, Net Profits earned during a year are ₹50,000. Upon distributing profits in their ratio, 2:2:1, their profit shares come to ₹20,000; ₹20,000 and ₹10,000 respectively and there is a shortage of ₹10,000 to Tanuja. Now there are several possibilities, some of these are:

Situation No. 1 – When shortage or Deficiency of Tanuja, ₹10,000, is borne only by one partner say, Ojasvi, it will be deducted from Ojasvi's share and added in Tanuja's share. So, their final profits will be as follows:

Ojasvi : (20,000 – 10,000) = ₹10,000

Samriddhi :(20,000 – 0) = ₹20,000

Tanuja : (10,000 + 10,000) = ₹20,000

Situation No. 2 – When shortage of Tanuja, ₹10,000, is borne the firm i.e. by both the other partners Ojasvi and Samriddhi in their Profit sharing ratio viz. 2:2 or 1:1. In this case ₹5,000 each will be deducted from the profit share of Ojasvi and Samriddhi and added in the share of Tanuja.

Ojasvi : (20,000 – 5,000) = ₹15,000

Samriddhi :(20,000 – 5,000) = ₹15,000

Tanuja : (10,000 + 5,000 + 5,000) = ₹20,000

Situation No. 3 – When shortage of Tanuja, ₹10,000, is borne by the firm in a ratio other than their profit sharing ratio say, 4:1. In this case 4/5 of ₹10,000 i.e. ₹8,000 will be borne by Ojasvi and 1/5 of ₹10,000, i.e. ₹2,000 will be borne by Samriddhi and these will be added in the share of Tanuja.

Ojasvi : (20,000 – 8,000) = ₹12,000

Samriddhi : (20,000 – 2,000) = ₹18,000

Tanuja : (10,000 + 8,000 + 2,000) = ₹20,000

1.1 When there are insufficient profits

Adjustment for guarantee is required when the annual profits earned by the firm are not sufficient to cover amount assured to the Beneficiary.

1.1.a. Guarantee by any one partner to another

In this case any one of the existing partners gives guarantee to another partner that his share in profits will not be less than a certain minimum amount. Thus shortage is borne individually.

Steps to be followed:

1.	Distribute available net profits among all the partners in their profit sharing ratio
2.	Compare actual share of 'Beneficiary' with the amount guaranteed, to compute deficiency
3.	Make accounting treatment or pass journal entry as per the requirement of question.
4.	In the Journal entry, Donor's Capital/Current Account is debited and Beneficiary's Capital/Current Account is credited.

Illustration1. Harish & Vivek are partner sharing profits and losses in the ratio of equally. They admitted Vinay firm for 1/5th share in profits. Harish personally guaranteed that Vinay's share in profits, will not be less than ₹ 20,000 in any year. Net profits for the year ended on 31st March,2020 amounted to be ₹ 80,000 and their new profit sharing ratio is 2:2:1.

Prepare Profit & Loss Appropriation Account to Show the distribution of profits.

Solution. **Profit & Loss Appropriation Account**

Dr. for the year ended on 31st March, 2020 **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Partners' Capital A/c: (Profits) Harish : 32,000 **(-) *Share given to Vinay*** ***4,000***	28,000	By Profit & Loss A/c (Net Profit)	80,000
Vivek : 32,000 Vinay: 16,000 **(+) *Share from Harish*** ***4,000***	32,000 20,000		
	80,000		80,000

Journal

Date	**Particulars**	**L.F.**	**Dr.**(in ₹)	**Cr.** (in ₹)
	Profit & Loss Account Dr. **To Profit & Loss Appropriation A/c** (*Being profits transferred to P & L Appropriation A/c.*)		80,000	 80,000
	Profit & Loss Appropriation Account Dr. **To Harish's Capital Account** **To Vivek's Capital Account** **To Vinay's Capital Account** (*Being actual profits for the year distributed among the partners in their profit sharing ratio.*)		80,000	 32,000 32,000 16,000
	Harish's Capital Account Dr. **To Vinay's Capital Account** (*Being shortage of profits to Vinay borne by Harish.*)		4,000	 4,000

Working Notes: Statement of Computation of Shortage of Profits to Vinay and its adjustment:

Particulars	Harish	Vivek	Vinay
Actual Profits as per Profit Sharing Ratio (80,000 ÷2:2:1)	**32,000**	**32,000**	**16,000**
Adjustment for shortage/guarantee	**(4,000)**	**-**	**4,000**
Final Profits	**28,000**	**32,000**	**20,000 Guaranteed**

1.1.b. Guarantee by the firm

Guarantee by the firm means 'Beneficiary' will be compensated for shortage by all the other partners of the firm. In this case shortage/deficiency is borne by the donors either in their 'profit sharing ratio' or in 'any other agreed ratio 'as per the deed.

Steps to be followed are:

1.	Distribute actual net profits among all the partners in their profit sharing ratio
2.	Compare actual share of 'Beneficiary' with the amount guaranteed, to compute deficiency
3.	Divide the amount of shortage among donors
4.	Make accounting treatment or pass journal entry as per the requirement of question
5.	In the Journal entry Donors' Capital/Current Accounts are debited and Beneficiary's Capital/Current Account is credited

Illustration 2 Raj, Vijay and Rashmi are partners with capitals of ₹ 5,00,000, ₹ 2,50,000 and 2,50,000 respectively. Profits are divisible in the ratio 5 : 3 : 2. But Raj and Vijay have guaranteed that Rashmi's share in the profits after providing for interest on capital @ 10% p.a. shall not be less than ₹ 36,000. Net Profits for the year ended 31st March, 2020are₹ 2,00,000, before charging interest on capital. You are required to show distribution of profit.

Solution. {**Option 1**} **Profit &Loss Appropriation Account**

Dr. for the year ended on 31st March, 2020 **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Interest on Capital: Raj : 50,000 Vijay : 25,000 Rashmi : 25,000	1,00,000	By Profit & Loss A/c (Net Profit)	2,00,000

To Partners' Capital A/c: (Profits) Raj : 50,000 (-) ***Share given to Rashmi*** **10,000**	40,000		
Vijay : 30,000 (-) ***Share given to Rashmi*** **6,000**	24,000		
Rashmi : 20,000 (+) ***Share from Raj*** **10,000** (+) ***Share from Vijay*** **6,000**	36,000		
	2,00,000		2,00,000

Working Notes:

Statement of Computation of Deficiency to Rashmi and its Compensation

Particulars	**Raj**	**Vijay**	**Rashmi**
Actual Profits as per Profit Sharing Ratio (1,00,000 ÷5:3:2)	**50,000**	**30,000**	**20,000**
Adjustment for shortage/deficiency (₹16,000) in the ratio 5:3	**(10,000)**	**(6,000)**	**16,000**
Final Profits	**40,000**	**24,000**	**36,000**

Shortage/Deficiency = Guaranteed Profit – Actual Profit

= 36,000 – 20,000 or ₹ 16,000

OR

{**Option 2**} **Profit & Loss Appropriation Account**

Dr. *for the year ended on 31st March, 2020* **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Interest on Capital: Raj : 50,000 Vijay : 25,000 Rashmi : 25,000	1,00,000	By Profit & Loss A/c (Net Profit)	2,00,000
To Net Divisible Profits c/d	1,00,000		
	2,00,000		2,00,000

To Partners' Capital A/c: (Profits) Raj : 50,000 (-) ***Share given to Rashmi*** **10,000** Vijay : 30,000 (-) ***Share given to Rashmi*** **6,000** Rashmi : 20,000 (+) ***Share from Raj*** **10,000** (+) ***Share from Vijay*** **6,000**	 40,000 24,000 36,000	By Net Divisible Profits b/d	1,00,000
	1,00,000		1,00,000

Illustration3. Manan and Raman share profits and losses in the ratio of 2:1. They admit Kanan as a partner with ¼thshare in profits with a guarantee that his share of profit will not be less than ₹40,000 and shortage if any will be borne by Manan and Raman **equally**. Net Profit of the firm for the year ending March 31, 2020 was **₹** 1,20,000.

Prepare Profit and Loss Appropriation Account and also pass journal entries.

Solution: **Profit & Loss Appropriation Account**

Dr. for the year ended on 31st March, 2020 **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Partners' Capital A/c: (Profits)	52,000 28,000 40,000	By Profit & Loss A/c (Net Profit)	1,20,000
Manan : 60,000 (-) ***Share given to Kanan*** **5,000** Raman : 30,000 (-) ***Share given to Kanan*** **5,000** Kanan : 30,000 (+) ***Share from Manan*** **5,000** (+) ***Share from Raman*** **5,000**			
	1,20,000		1,20,000

Working Notes: -

Deficiency or Shortage = Guaranteed Profit Share – Actual Profit Share

= 40,000 – 30,000

= ₹ 10,000

This shortage of profit to Kanan will be borne by Manan & Raman in the decided ratio 1:1

Shortage borne by Manan& Raman is 1/2 of 10,000 each i.e. ₹ 5,000 each.

1.2 When there are sufficient profits

Adjustment for guarantee is not required when annual profits earned by the firm are sufficient to cover the amount assured to Beneficiary.

Steps to check whether adjustment for guarantee is required or not:

1.	Distribute actual net profits among all the partners in their profit sharing ratio.
2.	Compare actual share of 'Beneficiary' with the amount guaranteed.
3.	If Actual profit share of Beneficiary ≫the Guaranteed Amount then no adjustment is required.

Illustration4'A' and 'B' share profits and losses in the ratio of 2:1. On1st October, 2019 they admitted 'C' into their firm who is to get**1/10** of future profits with a **guaranteed minimum of ₹ 22,000 every year**. 'A' and 'B' continue to share profits as before but agree to bear any deficiency on account of guarantee to 'C' in the ratio of 17:13. Net Profits of the firm for the year ending 31st March, 2020 amounted to **₹** 1,20,000. Prepare Profit and Loss Appropriation Account.

Solution: **Profit & Loss Appropriation Account**

Dr. for the year ended on 31st March, 2020 **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Partners' Capital A/c: (Profits) A : 72,000 B : 36,000 C : 12,000	1,20,000	By Profit & Loss A/c (Net Profit)	1,20,000
	1,20,000		1,20,000

Working Notes: Division of Profits:

Total Profit	1,20,000	A's Share is 2/3 of 1,08,000 = 72,000
C's Share is 1/10 of 1,20,000	12,000	B's Share is 1/3 of 1,08,000 = 36,000
Remaining Share	**1,08,000**	

- Guaranteed Profit is ₹ 22,000 whereas, Actual Profits share of 'C' is only 12,000.
- Guaranteed amount ₹22,000 is Annual whereas, 'C' was admitted on 1st October, 2019 so, for current year his guarantee is limited to 22,000 x 6/12 i.e. ₹11,000.
- C's actual share in profit during current year is ₹12,000 which is more than the guaranteed amount of ₹11,000. In the absence of short age no adjustment is required.

1.3 When firm incur losses

When firm incurs losses, then 'Donor' partners have to bear the losses as per the agreement.

Steps to be followed are:

1.	Distribute 'Net Loss' among all the partners in their profit sharing ratio; To pass journal entry Debit All Partners Capital A/c and Credit Profit & Loss Appropriation A/c.
2.	To compute deficiency, use the following formula: **Deficiency to the 'Beneficiary' = Guaranteed Profit Share + His Actual Share in Loss**
3.	Divide the total amount of shortage among donors.
4.	To pass journal entry for guarantee adjustment, Donor Partners' Capital/Current Accounts are debited and Beneficiary's Capital/Current Account is credited.

Illustration5 Robin and Ali are partners sharing profits in the ratio of 3:1. They admitted Mohan for 1/3 share in profits with a guaranteed minimum amount of **₹ 15,000**. Both Robin and Ali undertake to meet the liability arising out of this guarantee to Mohan in their respective profit sharing ratio. The profit sharing ratio between Robin and Ali does not change. The firm incurred a loss of ₹ 75,000 during the year 2019-20. Pass the journal entries to show the distribution of profits or losses and adjustment of guarantee.

Solution: **JOURNAL**

Date	Particulars	L.F.	Dr.(in ₹)	Cr. (in ₹)
	Profit & Loss Appropriation Account Dr. **To Profit & Loss Account** (*Being losses transferred to P & L Appropriation A/c.*)			
	Robin's Capital Account Dr. **Ali's Capital Account Dr.**		37,500 12,500	

	Mohan's Capital Account Dr. **To Profit & Loss Appropriation Account** (*Being losses for the year distributed among the partners.*)		25,000	75,000
	Robin's Capital Account Dr. **Ali's Capital Account Dr.** **To Mohan's Capital Account** (*Being shortage of Mohan borne by Robin and Ali in their mutual ratio viz. 3:1.*)		30,000 10,000	40,000

Working Notes: **Shortage = Guaranteed Profit Share + Actual Share in Loss**

= 15,000 + 25,000 or ₹ 40,000

This shortage of profit to Mohan will be borne by Robin & Ali in the decided ratio 3:1

Shortage borne by Robin=3/4 of 40,000 i.e. ₹30,000&Shortage borne by Ali=1/4 of 40,000 i.e. ₹ 10,000.

2. Guarantee to two or more partners – For example, Guarantee to one partner by the firm and to a partner

Illustration 6 'Ram', 'Laksh', 'Bharat' and 'Shatru' formed a partnership and agreed to share profits in the ratio of 6:3:2:1.Shatru's share in profit is guaranteed not to be less than ₹23,800 p.a. 'Bharat' was given guarantee by 'Laksh' that his share will not be less than ₹32,000. Profit for the year ended on 31st March, 2020 are ₹1,80,000.

Prepare the relevant account to distribute profits among the partners.

Solution. **Profit & Loss Appropriation Account**

Dr. *for the year ended on 31st March, 2020* **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Partners Capital A/c: (Profit) RAM : 90,000 - Share given to Shatru- 4,800 LAKSH : 45,000 - Share given to Shatru- 2,400	 85,200	By Profit & Loss A/c (Net Profit)	1,80,000

42,600 - Share given to Bharat - 3,600	39,000		
BHARAT : 30,000 - Share given to Shatru - 1,600 28,400 + ***Share from Laksh*** + 3,600	32,000		
SHATRU : 15,000 + ***Share from Ram*** + 4,800 + ***Share from Laksh*** + 2,400 + ***Share from Bharat*** +1,600	23,800		
	1,80,000		1,80,000

Working Notes:

i. Shortage of Shatru = Guaranteed Profit – Actual Profit

= 23,800 – 15,000 or ₹ 8,800

It will be borne by the firm i.e. all the other partners in their profit sharing ratio viz. 6:3:2.

ii. Shortage of Bharat = Guaranteed Profit – Actual Profit

= 32,000 – 28,400 or ₹ 3,600

It will be borne by Laksh alone because it is his personal guarantee.

3. Guarantee of profits including interest on capital, salary/commission etc.

Illustration7 Meena, Teena and Reena are partners sharing profits and losses in the ratio of 2:2:1. Their fixed capital is ₹ 2,00,000 each. Partners are entitled to interest on capitals @ 5% p.a. ‘Teena’ is allowed a commission @ 5% on Net Profit and ‘Reena’ is entitled to get a salary of₹2,250 per quarter.

It was agreed that total benefit to ‘Teena’, including interest on capital &commission will not be less than ₹55,000. Shortage if any will be borne by Meena & Reena.

The net profits for the year 2019-20 before commission, interest on capital and salary to partner amounted to ₹ 1,20,000.Prepare Profit and Loss Appropriation A/c.

Solution:

Profit & Loss Appropriation Account

Dr. for the year ended on 31st March, 2020 **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Interest on Capital: Meena's Current A/c - 10,000 Teena's Current A/c - 10,000 Reena's Current A/c - 10,000	30,000	By Profit & Loss A/c (Net Profit)	1,20,000
To Commission to Teena	6,000		
To Salary to Reena (2,500 x 4)	9,000		
To Net Divisible Profits c/d	75,000		
	1,20,000		1,20,000
To Partners' Current A/c:(Profits) Meena : 30,000 **(-) *Share given to Teena*- 6,000**	34,000	By Net Divisible Profits b/d	75,000
Teena : 30,000 **(+) *Share from Meena* +6,000** **(+) *Share from Reena*+3,000**	39,000		
Reena : 15,000 **(-) *Share given to Teena*- 3,000**	36,000		
	80,000		80,000

Working Notes:

Shortage = Guaranteed Amount – Actual Amount of profit including Interest on Capital & Commission

= 55,000 – [10,000 + 6,000 + 30,000] [*Int. on Cap.* + *Commission to Teena* + *Profit Share*]

= 55,000 – 46,000

= ₹ 9,000

This shortage of profit to Teena will be borne by Meena & Reena in the decided ratio 2:1

Shortage borne by Robin = 2/3 of 9,000 i.e. ₹ 6,000.

Shortage borne by Ali = 1/3 of 9,000 i.e. ₹ 3,000.

4. Guarantee by a partner to the firm

Illustration8 Vinita, Punya and Mehak form a partnership firm, sharing profits in the ratio of 3:2:1, subject to the following conditions:

(i) Mehak's share in the profits is guaranteed to be not less than ₹ 36,000 inany year.

(ii) Punya gives guarantee to the effect that gross fee earned by her for thefirm shall not be less than ₹ 60,000.

NetProfit for the year ended March 31, 2020 is ₹ 1,20,000. The gross fee earnedby Punya for the firm was ₹ 38,400.

You are required to show Profit and Loss Appropriation Account.

Solution: **Profit & Loss Appropriation Account**

Dr. for the year ended on 31st March, 2020 **Cr.**

Particulars	Amt. (in ₹)	Particulars	Amt. (in ₹)
To Partners Capital A/c: (Profits)		By Profit & Loss A/c (Net Profit)	1,20,000
Vinita :70,800			
(-) *Share given to Teena* - 7,440	63,360		21,600
Punya :47,200		By Punya's Capital A/c	
(-) *Share given to Teena* - 4,960	42,240	(Shortage in Fee Earned)	
Mehak : 23,600			
(+) *Share from Vinita* + 7,440			
(+) *Share from Punya* + 4,960	36,000		
	1,41,600		1,41,600

Working Notes:

i. Shortage of Fee from Punya = Fee Guaranteed by her – Actual Fee earned by her

= 60,000 – 38,400 or ₹21,600

ii. Shortage of Profits to Mehak = Guaranteed Profit – Actual Profit share

= 36,000 – 23,600 or ₹12,400

It will be borne by the firm i.e. other partners Vinita &Punya in their profit sharing ratio viz. 3:2.