

FINANCIAL ACCOUNTING IV

Capital Accounts

Fixed and Fluctuating

A Capital Account is a general ledger account which shows some of the special transactions like proprietor's investment in his own business, the aggregate amount of earning, expenses of companies, etc. There are many more transactions which affect the Capital. Like: Interest on Capital, Interest on Drawings, Salaries to the Partners, Commission for the Partners, etc. These values are put in Profit and Loss Appropriation Account and at the same time credited or debited to their respective Capital Accounts.

Methods of Capital Account Creation

- Fluctuating Capital Account Method
- Fixed Capital Account Method

Fluctuating Capital Account Method

Fluctuate means anything having unpredictable ups and downs. Hence, under this method, the Capital of each Partner keeps on changing from time to time.

In a firm, there is a single account under the name "Capital" which shows all the necessary information about the different transactions related to the capital. It mostly starts with a credit amount of the capital invested by the partner in the initial time of the business.

All the adjustments leading to a decrease in the Capital are shown on the Debit side of the Capital Account. For example, Drawings by Partners and interest comes on the debit side of the Capital account. All the adjustments leading to an increase in the Capital are shown on the Credit side.

The items that usually appear on the debit and the credit side of the Partners' capital account are :

• Credit Side

1. Capital introduced or the opening balance;
2. Additions to capital made during the year, if any;
3. Interest on capital, if any;
4. Salary to the partners, if any;
5. Commission and bonus to the partners;
6. Share of profit.

• Debit Side

1. Drawings made during the year, if any;
2. Interest on drawings, if any;
3. Share of loss, if any;

4. Withdrawal of capital, if any;
5. Closing Balance.

Thus, the capital account of a partner will appear as follows:

Partners' Capital Account							
Dr.				Cr.			
Date	Particulars	J.F	Amount (Rs.)	Date	Particulars	J.F	Amount (Rs.)
	Drawings		* * *		Opening balance		* * *
	Interest on drawings		* * *		Addition to capital		* * *
	Share of loss		* * *		Interest on capital		* * *
	Withdrawal of capital		* * *		Salary		* * *
	Closing balance		* * *		Commission/Bonus		* * *
			* * *		Share of profit		* * *
			* * *				
	Total		* * *		Total		* * *

Format under fluctuating method

Note : A Partners' Capital Account usually shows a credit balance. It can, however, show a debit balance under certain circumstances, such as over withdrawal or insolvency of the partner.

Fixed Capital Account Method

Under this method, the firm prepares Two accounts which show different transactions related to the capitals of the partners.

These two accounts are as follows :

(a) Fixed Capital Account

A firm prepares Fixed Account with very basic capital related transactions. Unlike the Capital account, under these repetitive capital related transactions does not affect the Capital balance. Like, Salary of employees, commission for employees, interest on capital, interest on drawings, etc.

The firm opens the account in the name of "Fixed Capital Account". Initial Investment will appear on the credit side as the starting entry. Only 2 kinds of Capital related transactions can affect its balance:

- (1) Addition of Capital
- (2) Permanent Withdrawal of Capital

(b) Current Account

It includes all the capital related transactions other than the initial investment of

capital, addition of capital and withdrawal of capital. Hence, It mainly includes items such as:

1. Interest on Capital
2. Interest on Drawings
3. Salaries and other remuneration to employees
4. Commission to employees and even more.

Under the fixed capital account method, the capital account and the current account would appear as shown below:

Partners' Capital Account							
Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>
	Withdrawal of capital		* * * *		Opening balance		* * * *
	Closing balance		* * * *		Addition to capital		* * * *
	Total		* * * *		Total		* * * *

Format under fixed capital method

Partners' Current							
Dr.				Cr.			
<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>
	Opening balance*		* * * *		Opening balance*		* * * *
	Drawings		* * * *		Interest on capital		* * * *
	Interest on drawings		* * * *		Salary		* * * *
	Share of loss		* * * *		Commission/Bonus		* * * *
	Closing balance*		* * * *		Share of profit		* * * *
	Total		* * * *		Total		* * * *

Format of Current Account

* In Partners' Current Account, opening balance and closing balance may appear on either side, i.e. debit or credit.

Difference Between Fixed and Fluctuating Capital Methods

Fixed Capital Method	Fluctuating Capital Method
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	Drawings		4,000		Cash		40,000
	Balance c/f		52,400		Salary		6,000
					Interest on Capital		2,400
					Profit and Loss		
					Appropriation A/c.		8,000
					(Share of profit $\frac{2}{3}$ of Rs. 12,000)		
	Total		56,400		Total		56,400

Sumit's Capital Account

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>
	Drawings		8,000		Cash		25,000
	Balance c/f		22,500		Interest on Capital		1,500
					Profit and Loss		4,000
					Appropriation A/c		
					(Share of profit $\frac{1}{3}$ of Rs.12,000)		
	Total		30,500		Total		30,500

(ii) When capitals are fixed.

Books of Amit and Sumit Amit's Capital Account

Dr.

Cr.

<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>	<i>Date</i>	<i>Particulars</i>	<i>J.F.</i>	<i>Amount (Rs.)</i>
	Balance c/f		40,000		Cash		40,000

	Drawings		8,000		Interest on Capital		1,500
					Profit and Loss Appropriation		4,000
					(Share of profit $\frac{1}{3}$ of Rs. 12,000)		
					Balance c/f		2,500
	Total		8,000		Total		8,000

