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	Dat	Particulars	J.F	Amount
			(Rs.)	e		•	(Rs.)
	Drawings	6	* * *		Opening balance		* * *
	Interest on		* * *	1/4	Addition to capital		* * *
	drawings				Interest on capital		* * *
	Share of loss				Salary		* * *
	Withdrawal		* * *		Commission/Bonus		* * *
	of capital		* * *	4	Share of profit		* * *
	Closing balance						
		1	* * *			4	
V 44)	(1)		* * *		16/12		
	Total (-	* * *	3	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 ondrawings, etc.

The firm opens the account in the name of "Fixed Capital Account". Initial Investmentwill 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

					Cr.
J.F	Amount	Dat	Particulars Particulars	J.F	Amount
/.//	(Rs.)	e	I I IN I		(Rs.)
	* * * *		Opening balance		* * * *
			Addition to		* * * *
	* * * *	1	capital		
) .		
	* * * *	5	Total		* * * *
5	S J.F	. (Rs.) * * * * * * * *	. (Rs.) e	. (Rs.) e **** Opening balance Addition to capital	. (Rs.) e **** Opening balance Addition to capital

Format under fixed capital method

Partners' Current

וע		/~	nada				Cr.
Dat e	Particulars	J. F.	Amoun t (Rs.)	Dat e	Particulars	J.F	Amou nt (Rs.)
	Opening balance* Drawings Interest on drawings	7	* * * * * * * * * * * * * * * * * * * *		Opening balance* Interest on capital Salary Commission/Bo	2	* * * * * * * * * * * * * * * * * * * *
	Share of loss Closing balance*		* * * * *		Share of profit Closing balance*		* * * * *
	Total		* * * *		Total		* * * *

Format of Current Account

Difference Between Fixed and Fluctuating Capital Methods

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

Two accounts are prepared: Capital Account and Current Account	Only a single account is prepared: Capital Account
The capital balance remains unchanged	Capital balance fluctuates
Both Capital and Current Accounts appears in the Balance sheet.	Only Capital Account appears in the Balance Sheet.
If this method is used then it must be specified in the Partnership Deed.	If this method is used then it is not necessary to specify the method under the Partnership Deed
Fixed Capital Account will always show a Credit Balance	Fluctuating Capital account may show debit balance as well.

Illustration 1 (Fixed and Fluctuating Capital Account)

Amit and Sumit commenced business as partners on April 1, 2000. Amit contributed Rs. 40,000 and Sumit Rs. 25,000 as their share of capital. The partners decided to share their profits in the ratio of 2:1. Amit was entitled to a salary of Rs. 6,000 p.a. Interest on capital was to be provided @ 6% p.a. The drawings of Amit and Sumit for the year ending March 31, 2001were Rs. 4,000 and Rs. 8,000, respectively. The profits of the firm after providing Amit's salary and interest on capital were Rs. 12,000.

Draw up the Capital Accounts of the partners:

- (i) When capitals are fluctuating, and
- (ii) When capitals are fixed.

Solution

(i) When capitals are fluctuating

Books of Amit and Sumit Amit's Capital Account

Dr. Cr.

Dat	Particulars	J.	Amoun	Dat	Particulars	J.F	Amoun
e		F.	t	e			t
			(Rs.)				(Rs.)

Drawings	4,000	Cash	40,000
Balance c/f	52,400	Salary	6,000
		Interest on Capital	2,400
	20.00000	Profit and Loss	
		Appropriation A/c.	8,000
N		(Share of profit 2/3	
		of Rs. 12,000)	
Total	56,400	Total	56,400

Sumit's Capital Account

Dr. Cr.

Dat	Particulars	J.	Amoun	Dat	Particulars	J.F	Amou
e		F.	t	e			nt
		5/1/	(Rs.)		11/1/2		(Rs.)
	Drawings		8,000		Cash		25,000
	Balance c/f		22,500	3	Interest on Capital		1,500
		() ()	~~~~		Profit and Loss	7	4,000
M		7			Appropriation A/c	/	
					(Share of profit 1/3		
		Z	17		of Rs.12,000)		7
	Total		30,500		Total		30,500

(ii) When capitals are fixed.

Books of Amit and Sumit Amit's Capital Account

Dr. Cr.

Dat e	Particulars	J.F	Amount (Rs.)	Dat e	Particulars	J.F	Amoun t (Rs.)
	Balance c/f		40,000		Cash		40,000

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Amit's Current Account

Dr. Cr.

Dat	Particulars	J.	Amount	Dat	Particulars	J.	Amoun
e		F.	(Rs.)	e		F.	t
							(Rs.)
	Drawings		4,000	Λ	Salary		6,000
	Balance c/f	7.	12,400	X W	Interest on Capital	30	2,400
3	6/		P		Profit and Loss		8,000
		1	/- /		Appropriation		
					(Share of profit 2/3	١	
	N.A.				of Rs. 12,000)		
	Total	1)	16,400		Total		16,400

Sumit's Capital Account

Dr. Cr.

Dat e	Particulars	J.F	Amount (Rs.)	Dat e	Particulars	J.F	Amou nt (Rs.
	Balance c/f		25,000	7	Cash		25,00 0

Sumit's Current Account

Dr. Cr.

Dat e	Particulars	J.F	Amoun t (Rs.)	Dat e	Particulars	J.F	Amou nt (Rs.
)

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

