Warm Greetings!

Dear students this is the 43rd notes for you. In this notes we are going to learn about Capital and Revenue Transactions.

The following points are to be recalled before learning capital and revenue transactions:

- Matching concept
- Periodicity concept
- Income and expenditure

Introduction:

In case of certain expenses, the benefit accrues only in the relevant accounting period. They are called revenue expenditures. For example, salaries, rent, etc. But in case of certain expenditures benefit extends beyond one accounting period. They are called capital expenditures.

To exhibit a true and fair view of profitability and state of affairs, proper allocation of capital and revenue items is required. The revenue items are to be shown in the trading and profit and loss account and capital items are to be shown in the balance sheet.

Considerations in determining capital and revenue expenditures:

(i) Nature of business

Expenditure on purchase of goods is revenue expenditure. Expenditure on purchase of asset is capital expenditure. Whether an item of expenditure is goods or asset depends on the nature of business. Goods include articles or commodities in which the business is dealing with. For example, for a trader dealing in furniture, purchase of furniture is revenue expenditure but for any other trade, the purchase of furniture should be treated as capital expenditure and shown in the balance sheet as asset. Therefore, the nature of business is very important criteria in classifying expenditure between capital and revenue.

(ii) Effect on revenue generating capacity of business

If expenditure helps to generate income or revenue in the current accounting period, it is revenue expenditure. On the other hand, if expenditure helps to generate revenue for more than one accounting period, it is capital expenditure.

(iii) Purpose of expenditure

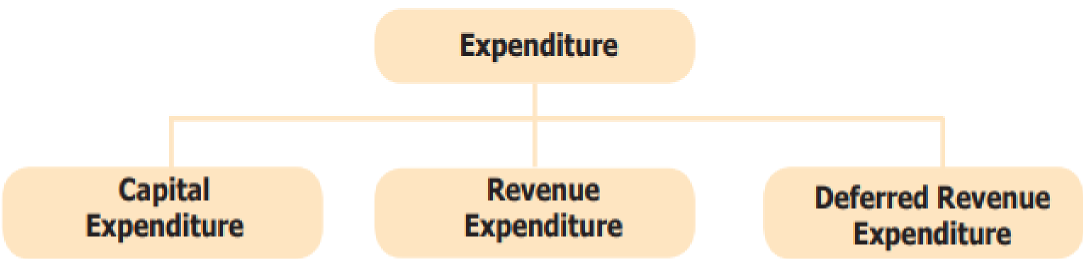
If expenditure is incurred in the normal course of maintenance of an asset, it is revenue expenditure. On the other hand, if expenditure is incurred for major repair of an asset which increases its productive capacity, it is capital expenditure.

(iv) Materiality of the amount involved

Relative proportion of the amount involved is considered in distinguishing between revenue expenditure and capital expenditure. If the amount of expenditure is material, it is treated as capital expenditure even if the expenditure does not increase the productive capacity of the asset. On the other hand, when the amount of expenditure is immaterial, it is treated as revenue even if the benefit of the expenditure extends beyond one accounting period. For example cost of waste basket is treated as revenue expenditure.

Classification of expenditure:

Expenditures may be classified into the following three categories: (i) Capital expenditure (ii) Revenue expenditure (iii) Deferred revenue expenditure.



Capital expenditure:

It is an expenditure incurred during an accounting period, the benefits of which will be available for more than one accounting period. It includes any expenditure resulting in the acquisition of any fixed asset or contributes to the revenue earning capacity of the business. It is non- recurring in nature.

Features of capital expenditure

Following are the features of capital expenditure:

(i) It gives benefit for more than one accounting period.

(ii) It includes acquisition of fixed assets and all expenditure incurred up to the point an asset is ready for use.

(iii) It contributes to the revenue earning capacity of the business.

(iv) It is non-recurring in nature.

(v) It is shown on the assets side of the balance sheet.

Examples

- Cost of acquisition of land and building.
- Cost of acquisition of office equipment, computer and air-conditioner.
- Cost of acquisition of plant and machinery including installation charges and trial run.

Revenue expenditure

The expenditure incurred for day to day running of the business or for maintaining the earning capacity of the business is known as revenue expenditure. It is recurring in nature. It is incurred to generate revenue for a particular accounting period. The revenue expenditure may be incurred in relation with revenue or in relation with a particular accounting period. For example, cost of purchases is a revenue expenditure related to sales revenue. Rent and salaries are related to a particular accounting period.

Features of revenue expenditure:

Following are the features of revenue expenditure:

(i) It is recurring in nature.

(ii) It is incurred for maintaining the earning capacity of the business.

(iii) Its benefit expires in the same accounting period.

(iv) It is shown on the debit side of the trading and profit and loss account.

Examples

- Purchase of goods for resale.
- Administrative, selling and distribution expenses.

• Manufacturing expenses.

Deferred revenue expenditure

An expenditure, which is revenue expenditure in nature, the benefit of which is to be derived over a subsequent period or periods is known as deferred revenue expenditure. The benefit usually accrues for a period of two or more years. It is for the time being, deferred from being charged against income. It is charged against income over a period of certain years.

Features of deferred revenue expenditure

Following are the features of deferred revenue expenditure:

(a) It is a revenue expenditure, the benefit of which is to be derived over a subsequent period or periods.

(b) It is not fully written off in the year of actual expenditure. It is written off over a period of certain years.

(c) The balance available after writing off (i.e., Actual expenditure - Amount written off) is shown on the assets side balance sheet.

Examples

• Considerable amount spent on advertising

• Major repairs to plant and machinery.

Comparison of capital, revenue and deferred revenue expenditure

Following are the points of comparison among capital, revenue and deferred revenue expenditure.

Basis	Capital expenditure	Revenue expenditure	Deferred revenue expenditure
i) Nature	It is non – recurring in nature.	It is recurring in nature.	It is non- recurring in nature.
ii) Purpose	To contribute to the revenue earning capacity of the business.	To carry on the day to day activities of the business.	To get benefit for certain years.
iii) Period of benefits	Its benefit is available for a longer period.	Its benefit is obtained within one accounting period.	Its benefit is available for more than one accounting period.

iv) Effect on profit earning capacity	It increases the profit earning capacity of the business.	It maintains the profit earning capacity of the business.	It is of benefit to the business for certain years.
v) Accounting treatment	It will appear on the assets side of the balance sheet.	It will be shown on the debit side of the trading and profit and loss account depending on whether direct or indirect in nature.	The amount written off during the year is shown on the debit side of profit and loss account and the unwritten off portion is shown on the asset side.