BCM-102

FINANCIAL ACCOUNTING

UNIT-13 CAPITAL AND REVENUE TRANSACTIONS, RESERVE & PROVISIONS

(B. COM. FIRST YEAR)

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Capital and Revenue Items

- All the revenue items are recorded in trading and profit & loss account and capital items are recorded in balance sheet. If these are not recorded properly then neither trading and profit & loss account would depict true profit nor would loss nor balance sheet depict true financial position. Hence for the knowledge of true financial result of business it is necessary to differentiate between two. Revenue expense is costs in day to day running of the business for example servicing a machine, spare parts etc. Revenue expenditure is normally charged against profit in the Income statement in the year it is expensed.
- Capital expenditure is on an item that will help generate profits over the longer term (12 months or more) so a purchase of a machine or van etc. The item is depreciated over the items useful life and each depreciate able amount is charged to the Income statement in the year the item has help generate profit.

Expenditure Items

- In the business there are thousands of items of expenditure. The following are some of these expenditures which are generally incurred in all types of business:
- Expenditure on:
- Purchase of goods
- Wages
- Purchase of raw material
- Import duty
- Coal , gas, water, oil, heating and lighting
- Salaries
- Rent, rates , taxes
- Stationary and printing
- Repairs and renewals
- Depreciation on fixed assets
- Office expense
- Research and development

Types of Expenditure

- **Capital Expenditure**
- Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. This type of outlay is made by companies to maintain or increase the scope of their operations. These expenditures can include everything from repairing a roof to building a brand new factory. The amount of capital expenditures a company is likely to have depends on the industry it occupies. Some of the most capital intensive industries include oil, telecom and utilities.

Types of Expenditure

Revenue Expenditure: All the expenditures which are incurred in the day to day conduct and administration of a business and the effect-of which is completely exhausted within the current accounting year are known as **"revenue expenditures"**. These expenditures are recurring by nature i.e. which are incurred for meeting day today requirements of a business and the effect of these expenditures is always short-lived i.e. the benefit thereof is enjoyed by the business within the current accounting year. These expenditures are also known as "expenses or expired costs." e.g. Purchase of goods, salaries paid, postages, rent, traveling expenses, stationery purchased, wages paid on goods purchased etc. This expenditure is incurred on items or services which are useful to the business but are used up in less than one year and, therefore, only temporarily increase the profit-making capacity of the business.

Types of Expenditure

Deferred Revenue Expenditure : Sometimes, some expenditure is of revenue nature but its benefit likely to be derived over a number of years. Such expenditure is called deferred revenue expenditure. The two examples of deferred revenue expenditure and their treatment in final accounts: When a new firm enters in to market, it undertakes special advertising campaign on which it spends heavy amount. The benefit of this expenditure will certainly come in some future years. Hence it will not be justified to charge this expenditure only in the profit and loss account of the year in which it incurred. This expenditure must be spread over the period over which the benefit is likely to lose. Suppose this expenditure will cover 3 years. Hence 1/3 of the expenditure must be charged to each year Profit and Loss Account.

Difference between Capital Expenditure and Revenue Expenditures

S. No	**Capital Expenditures**	**Revenue Expenditures**
1	Its effect is long term i.e., it is not exhausted within the current account year. Its benefit is enjoyed in future year or years also. In a word, its effect is reduces gradually.	Its effect is temporary, i.e., it is exhausted within the current accounting year
2	An asset is acquired or the value of an asset is increased as a result of this expenditure.	Neither an asset is acquired nor is the value of an asset increased.
3	It does not occur again and again - it is non-recurring and irregular.	It occurs repeatedly - It is recurring and regular.
4	Generally, it has physical existence i.e., it can be seen with eyes.	It has no physical existence, i.e., it cannot be seen with eyes.
5	This expenditure improves the position of the concern.	This expenditure helps to maintain the concern.
6	A portion of this expenditure is shown in the trading and profit and loss account or income and expenditure account as depreciation.	The whole amount of this expenditure is shown in trading and profit and loss account or income and expense account. But deferred revenue expenditures and prepaid expenses are not shown.
7	It appears in balance sheet until its benefit is fully exhausted.	It does not appear in balance sheet. Deferred revenue expenditure, outstanding expenditure, outstanding expenses and prepaid expenses, however, temporarily shown in the balance sheet.
8	It does not reduce the revenue of the concern. Purchase of fixed assets does not affect revenue.	It reduces revenue. Payment of salaries to employees decreases revenue.

Capital and Revenue Profits & Losses

- **Capital Profit and Revenue Profits:** Capital profit means a profit made on the sale of a fixed asset or profit earned on raising monies for the business. For example a building purchased for Rs.20,000 is sold for Rs.25,000 the profit Rs.5,000 thus made is a capital profit and Revenue profit on the other hand is a profit made by the business e.g., profit on the sale of goods, income from investments, commission earned etc.
- Whenever, capital profit is made it should either be transferred to the capital account of the proprietor or credited to capital reserve account which would appear as a liability on the balance sheet. But capital profits should in no case be transferred to profit and loss account because it is non-trading profit. Revenue profits on the other hand should be transferred to profit and loss account because they arise out of regular trading operation.
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- **Capital Losses and Revenue Losses:** Capital loss means a loss made on the sale of a fixed asset or a loss incurred in connection with the raising of money for business. Capital loss may be shown as an asset in the balance sheet. But as this asset is a fictitious nature, it would advisable to write off it. Revenue loss, on the other hand, is the loss incurred in trading operations such as loss on the sale of goods. Revenue losses are charged to profit and loss account of the year in which they occur.

Distinction between Capital Receipt and Revenue Receipt

Revenue Receipt	Capital Receipt
1. It has short-term effect. The benefit is enjoyed within one accounting period.	1. It has long-term effect. The benefit is enjoyed for many years in future.
2. It occurs repeatedly. It is recurring and regular.	2. It does not occur again and again. It is nonrecurring and irregular.
3. It is shown in profit and loss account on the credit side.	3. It is shown in the Balance Sheet on the liability side.
4. It does not produce capital receipt.	4. Capital receipt, when invested, produces revenue receipt e.g. when capital is invested by the owner, business gets revenue receipt (i.e. sale proceeds of goods etc.).
5. This does not increase or decrease the value of asset or liability.	5. The capital receipt decreases the value of asset or increases the value of liability e.g. sale of a fixed asset, loan from bank etc.
6. Sometimes, expenses of capital nature are to be incurred for revenue receipt, e.g. purchase of shares of a company is capital expenditure but dividend received on shares is a revenue receipt.	6. Sometimes expenses of revenue nature are to be incurred for such receipt e.g. on obtaining loan (a capital receipt) interest is paid until its repayment.

Summary

- It is important to distinguish between revenue expenditure and a capital expenditure and between a revenue receipt and a capital receipt because only revenue items appear in the final accounts. **Revenue expenditure**: (1) Revenue Expenditure are considered as an expense and must be debited to the final account, whereas revenue receipts are revenue of the business and must be credited; whereas revenue receipts are revenue of the business and must be credited to the final account. (2) Revenue expenditure is cost incurred for the day-to-day running expenses of the business. They include the purchase of stock for resale, purchase of services such as employee's wages, electricity, water, and cost of carriage of goods, stationery, and depreciation on fixed assets. **Capital Expenditure:** Capital Expenditure is payments for the purchase of assets that can be used over and over again in the business. Normally, such assets can last for more than one accounting period. **Revenue Receipts:** Revenue receipts refer to receipts from the normal activities of the business. For example, revenue receipts of a trading organization are receipts from sale of goods, discounts received, commission received and interest on bank deposits. **Capital receipts:** Capital receipts refer to receipts that are derived from sources other than the normal trading activities of the business. It may comprise capital paid by partners, or in the case of a limited company, sums received from its shareholders or debenture holders, loans and proceeds from the sale of its assets.

References

- SILM developed by Uttarakhand Open University for BCM-102 (Financial Accounting), Year 2017, ISBN: 978-93-85740-44-2