Capital and Revenue Expenditure & Receipts

Understanding the Basics

Capital Expenditure: This refers to expenses incurred to acquire assets that have a useful life of more than one accounting period. These assets are typically used to generate income over a long period.

Revenue Expenditure: These are expenses that are incurred in the current accounting period and are fully consumed or used up within that period.

Capital Receipts: These are receipts that result from the sale or disposal of capital assets or from long-term loans.

Deferred Revenue Expenditure: These are expenses incurred in the current period but are expected to benefit future periods. They are treated as assets and are gradually written off over their useful life.

Key Features and Characteristics

Capital Expenditure

- Acquires assets with a useful life of more than one accounting period
- Increases business's productive capacity
- Results in future benefits
- Generally involves a significant outlay of funds

Capital Expenditure examples:

1. Purchase of a new factory for ₹5 crores
2. Construction of a new office building for ₹2 crores
3. Acquisition of land for ₹1 crore
4. Installation of a new solar power system for ₹50 lakhs
5. Purchase of a fleet of new trucks for ₹3 crores

Revenue Expenditure

- Consumed or used up within the current accounting period
- Relates to day-to-day operations
- Does not increase future benefits
- Typically involves smaller amounts

Revenue Expenditure examples

1. Purchase of office supplies for ₹50,000

2. Payment of employee salaries for ₹2 lakhs per month
3. Advertising expenses for ₹1 lakh per month
4. Utility bills for ₹20,000 per month
5. Repair and maintenance costs for ₹50,000 per year

Capital Receipts

- Result from the sale or disposal of capital assets or long-term loans
- Increase the financial resources of the business
- May be used to finance capital expenditure or reduce liabilities

Capital Receipts examples

1. Sale of an old factory for ₹2 crores
2. Sale of obsolete machinery for ₹5 lakhs
3. Receipt of a long-term loan from a bank for ₹10 crores
4. Issue of new shares for ₹5 crores
5. Sale of investments for ₹1 crore

Deferred Revenue Expenditure

- Incurred in the current period but benefits future periods
- Treated as assets on the balance sheet
- Gradually written off over their useful life
- Examples include research and development costs, pre-operating expenses

Deferred Revenue Expenditure

1. Research and development costs for a new product, ₹1 crore
2. Pre-operating expenses (e.g., advertising costs before starting operations), ₹50 lakhs
3. Costs incurred for obtaining a patent or trademark, ₹2 lakhs
4. Costs of training employees for new skills, ₹1 lakh
5. Costs of developing new software, ₹50 lakhs

Illustrations

Example 1: A company purchases a new machine for ₹20 lakhs. This is a capital expenditure as the machine will be used to generate income over several years.

Example 2: A company pays ₹5,000 for office supplies. This is a revenue expenditure as the supplies will be used up within the current accounting period.

Example 3: A company sells a piece of land for ₹50 lakhs. This is a capital receipt as the land was a capital asset.

Example 4: A company spends ₹10 lakhs on research and development for a new product. This is a deferred revenue expenditure as the benefits from the research will be realized in future periods.

By understanding the distinctions between capital and revenue expenditure and receipts, you can accurately classify expenses and revenues, which is crucial for financial reporting and decision-making

MCQs on Capital, Revenue, and Deferred Revenue Expenditure

(Students should try these questions and the answers will be discussed in the class)

1. Which of the following is a capital expenditure?

- a) Salary of employees
- b) Purchase of office stationery
- c) Purchase of a new factory
- d) Advertising expenses

2. Capital expenditures are incurred to:

- a) Increase the revenue of the business
- b) Improve the efficiency of the business
- c) Enhance the future earning capacity of the business
- d) All of the above

3. Which of the following is not a capital expenditure?

- a) Purchase of land
- b) Construction of a building
- c) Repair of existing machinery
- d) Purchase of new machinery

4. Revenue expenditures are incurred to:

- a) Acquire fixed assets
- b) Improve the future earning capacity of the business
- c) Generate revenue in the current period
- d) Both (a) and (b)

5. Which of the following is a revenue expenditure?

- a) Purchase of a new car for the business
- b) Construction of a new factory
- c) Payment of electricity bills
- d) Purchase of land

6. Revenue expenditures are generally:

- a) Large in amount
- b) Small in amount
- c) Long-term in nature
- d) Short-term in nature

7. Deferred revenue expenditure is:

- a) Expenditure incurred in the current period but benefits future periods
- b) Expenditure incurred in the future period but benefits the current period
- c) Expenditure incurred in the current period but has no future benefit
- d) Expenditure incurred in the future period but has no current benefit

8. Which of the following is an example of deferred revenue expenditure?

- a) Purchase of a new machine
- b) Payment of salaries
- c) Advertising expenses for a new product launch
- d) Repair of existing machinery

Matching

9. Match the following:
- a) Capital expenditure - i) Repairs and maintenance
- b) Revenue expenditure - ii) Purchase of land
- c) Deferred revenue expenditure - iii) Research and development costs
- d) None of the above - iv) Purchase of raw materials

10. Match the following:
- a) Capital expenditure - i) Electricity bills
- b) Revenue expenditure - ii) Construction of a new building
- c) Deferred revenue expenditure - iii) Advertising expenses for a new product
- d) None of the above - iv) Purchase of office stationery

True or False

11. Capital expenditures are recorded in the profit and loss account.
12. Revenue expenditures are recorded in the profit and loss account.
13. Deferred revenue expenditure is recorded as an asset in the balance sheet.
14. Capital expenditures are generally large in amount.
15. Revenue expenditures are generally small in amount

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16. The cost of repairing a damaged machine is classified as:
- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

17. The cost of training new employees is classified as:
- a) Capital expenditure
- b) Revenue expenditure

- c) Deferred revenue expenditure
- d) None of the above

18. The cost of advertising a new product is classified as:
- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

19. The cost of replacing a worn-out part of a machine is classified as:
- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

20. The cost of painting a building is classified as:
- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

21. The cost of acquiring a new patent is classified as:
- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

22. The cost of renovating an existing building is classified as:
- a) Capital expenditure
- b) Revenue expenditure

- c) Deferred revenue expenditure
- d) None of the above

23. The cost of purchasing a new computer system for the office is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

24. The cost of installing a new air conditioning system in the factory is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

25. The cost of acquiring a new delivery van for the business is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

26. The cost of purchasing stationery for the office is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

27. The cost of paying insurance premiums for the business is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure

- d) None of the above

28. The cost of paying salaries to employees is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

29. The cost of paying electricity bills for the business is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

30. The cost of paying property taxes for the business premises is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

31. The cost of developing a new software product is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

32. The cost of conducting market research for a new product is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure

- d) None of the above

33. The cost of training employees for a new project is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

34. The cost of obtaining a new license for the business is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

35. The cost of conducting a feasibility study for a new project is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

Matching

36. Match the following:

- a) Purchase of a new machine - i) Revenue expenditure
- b) Payment of rent - ii) Capital expenditure
- c) Research and development costs - iii) Deferred revenue expenditure

37. Match the following:

- a) Repair of existing machinery - i) Capital expenditure
- b) Purchase of raw materials - ii) Revenue expenditure
- c) Construction of a new building - iii) Deferred revenue expenditure

38. Match the following:
- a) Advertising expenses - i) Capital expenditure
- b) Acquisition of a new patent - ii) Revenue expenditure
- c) Payment of salaries - iii) Deferred revenue expenditure

39. Match the following:
- a) Purchase of land - i) Capital expenditure
- b) Payment of electricity bills - ii) Revenue expenditure
- c) Training employees for a new project - iii) Deferred revenue expenditure

40. Match the following:
- a) Payment of insurance premiums - i) Capital expenditure
- b) Renovation of existing building - ii) Revenue expenditure
- c) Acquisition of a new delivery van - iii) Deferred revenue expenditure

True or False

41. The cost of repairing a damaged machine is classified as a capital expenditure.
42. The cost of conducting market research for a new product is classified as a revenue expenditure.
43. The cost of training employees for a new project is classified as a deferred revenue expenditure.
44. The cost of acquiring a new patent is classified as a capital expenditure.
45. The cost of paying salaries to employees is classified as a deferred revenue expenditure.

Multiple-Choice Questions

46. The cost of purchasing a new computer system for the office is classified as:
- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

47. The cost of installing a new air conditioning system in the factory is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

48. The cost of acquiring a new delivery van for the business is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

49. The cost of purchasing stationery for the office is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above

50. The cost of paying insurance premiums for the business is classified as:

- a) Capital expenditure
- b) Revenue expenditure
- c) Deferred revenue expenditure
- d) None of the above