Capital and Revenue: Expenditure and Receipts

PRACTICAL QUESTIONS

Question 1:

State whether the following expenditure is a capital or revenue expenditure. Give reasons:

1) Cost of replacement of a defective part of the machinery.
2) Expenditure incurred in preparing a project report.
3) Expenditure for training employees for better running of machinery.
4) Expenditure incurred for repairing cinema screen.

Solution:

1) **Revenue expenditure;** as replacement of a defective part will help to maintain the machinery in working condition.
2) **Capital expenditure;** if the project is implemented; as according to Accounting Standard 10 all expenditure till a project commences is capitalised. However, if the project is given up or not implemented, and the amount is small it will be written off as revenue expenditure (as expired costs which will bring no benefit in future); if the project is not implemented and the amount is heavy, it will be treated as deferred revenue expenditure.
3) **Revenue expenditure;** as expenditure for training employees for better running of machinery is cost of administration related to normal business activities incurred in order to earn income during the year.
4) **Revenue expenditure;** as expenditure incurred for repairing cinema screen is a cost incurred to maintain an existing asset in working condition.

Question 2:

State, with reasons, whether you would consider the following as capital expenditure or revenue expenditure:

1) Amount spent on uniform of workers.
2) White-washing of the factory of building.
3) Cost of stores consumed in manufacturing machinery for installation in own factory.

4) Wages paid for construction of the building extension.
5) Import duty on raw material purchased.

Solution:

1) **Revenue expenditure;** as amount spent on uniform of workers is an administration cost related to normal business activities.
2) **Revenue expenditure;** as white-washing of the factory of building is a cost of maintaining an asset in working condition.
3) **Capital expenditure;** as cost of stores consumed in manufacturing machinery for installation in own factory is a direct cost incurred for acquiring an asset which is to be capitalised as per Accounting Standard 10.
4) **Capital expenditure;** as wages paid for construction of an extension to an existing asset is a direct cost incurred for acquiring an asset which is to be capitalised as per Accounting Standard 10.
5) **Revenue expenditure;** as import duty on raw material purchased is a direct product cost related to normal business activities incurred in order to earn income during the year.

Question 3:

State with reasons, whether you would consider the following as capital expenditure or revenue expenditure:

1) Raw material was imported when 1 dollar was worth ₹ 40; when payment was actually made the foreign exchange was purchased at the rate of 1 dollar equal to ₹ 42.
2) Premium paid in connection with acquisition of leasehold premises.
3) Renovation of factory canteen.
4) Fees paid for renewal of licence for factory.

Solution:

1) **Revenue expenditure;** as due to change in exchange rate, raw material cost, which is a direct product cost, has gone up.
2) **Capital expenditure;** as premium paid in connection with acquisition of leasehold premises is a direct cost incurred in connection with the acquisition of an asset to be added to the cost of that asset [Accounting Standard 10].
3) **Revenue expenditure;** as renovation of factory canteen helps to maintain the asset in working condition.
4) **Revenue expenditure;** as fees for renewal of factory licence is a recurring expenditure incurred in the course of normal business activities.

Question 4:

Neo Electric Engineers Private Limited removed their factory to a more suitable premises in Navi Mumbai. State with reasons the accounting treatment for the following items:

1) A sum of ₹ 99,500 was spent for dismantling, removing and re-installing plant, machinery and fixtures.
2) The removal of stock from the old factory to the new at a cost of ₹ 1,000.
3) Plant and machinery which stood in the books at ₹ 1,50,000 included a machine at a book value of ₹ 3,400. This being obsolete, was sold off at ₹ 900 and was replaced by a new machine which cost ₹ 4,800.
4) The freight and cartage on the new machine amounted to ₹ 300 and erection charges ₹ 550.
5) The furniture appeared in the books at ₹ 15,000. Of these, some portion of the book value at ₹ 3,000 was discarded and sold at ₹ 1,200. New furniture of the book value of ₹ 2,400 was acquired.
6) A sum of ₹ 2,200 was spent on painting the new factory.

Solution:

1) **Revenue expenditure;** It is treated as revenue expenditure and is fully written off.
2) **Revenue expenditure;** as removal of stock from the old factory to the new is a normal operating cost related to a current asset (stocks) and not capital asset.
3) When a machine costing ₹ 3,400 is sold for ₹ 900; ₹ 900 received on sale of machinery is treated as **capital receipts;** and the book value of the machine becomes ₹ 2,500. As been the machine has been the machine has sold its book value represents an 'expired cost with no future benefits i.e. loss on sale of asset which is to be written off by debit to the profit and loss account. Cost of new machine (₹ 4,800) will be treated as capital expenditure.
4) **Capital expenditure;** as freight and cartage on the new machine as well as the erection cost is a direct cost, of bringing an asset to a condition where it can be put to use, which is capitalized as per Accounting Standard 10.
5) Loss on sale of old furniture (3,000 - 1,200) is written off as expired cost by debit to the profit and loss account; cost of new furniture (₹ 2,400) will be treated as **capital expenditure**.
6) **Capital expenditure;** painting the new factory is a direct cost till an asset is first put to use, which is capitalised as per Accounting Standard 10.

Question 5:

Mr. Bindas Accountant seeks your help on the following transactions/events. How will you treat them?

1) Gave ₹ 1 lakh as custom duty on the machinery imported.
2) Invested ₹ 2 lakhs on the purchase of 2,000 equity shares of ₹ 100 each of a subsidiary company.

3) Spent ₹ 57,600 on the construction of a platform for the installation of machinery imported from abroad.
4) Placed a deposit of ₹ 3 lakhs with the bankers as margin money for obtaining guarantee of ₹ 10 lakhs in favour of Bharat Petroleum Limited.
5) Furniture worth ₹ 19,500 destroyed by fire, which was not insured.
6) Goods worth ₹ 27,000 distributed free amongst the workers on Diwali Pooja day.
7) Spent ₹ 39,600 on research, but subsequently the project was abandoned by the management.

Solution:

1) **Capital expenditure;** custom duty on the machinery imported is a direct cost of acquiring an asset which is to be capitalized as per Accounting Standard 10.
2) **Capital expenditure;** as purchase of shares is an investment.
3) **Capital expenditure;** as construction of a platform for the installation of machinery imported from abroad is a direct cost of bringing the asset to its intended use which is to be capitalized as per Accounting Standard 10.
4) **Capital expenditure;** as bank deposit is an investment which will be refunded in future.
5) **Capital loss,** as Furniture has been destroyed by fire, which was not insured and a capital asset has been lost, which will be written off in the profit and loss account as an expired cost from which no benefit can be expected in future.
6) **Revenue expenditure;** as cost of goods distributed free amongst the workers on Diwali Pooja day is an expired cost from which no benefit can be expected in future.
7) **Revenue expenditure;** as cost of research on a project subsequently abandoned by the management is an expired cost from which no benefit can be expected in future.

Question 6:

State with reasons whether the following items relating to a sugar mill company are capital or revenue:

1) A motor truck costing ₹ 15,000 and standing in the books at ₹ 7,250 was sold for ₹ 12,000.
2) ₹ 20,000 received from the issue of further shares.
3) ₹ 75,000 being cost of land purchased for agricultural farm and ₹ 450 paid for land revenue.
4) ₹ 1,50,000 paid for excise duty on sugar manufactured.
5) ₹ 50,000 invested in a government loan.
6) ₹ 60,000 spent on construction of railway siding.

Solution:

1) **Capital receipt;** as ₹ 12,000 is received from sale of a capital asset. The profit on sale of asset (12,000-7,250) will be credited to the profit and loss account as an extraordinary item of income.
2) **Capital receipt** (₹ 20,000)**;** as amount has been received from issue of shares in the course of financing activity of the company.
3) ₹ 75,000 will be treated as capital expenditure as agricultural land is a capital asset; ₹ 450 paid for land revenue is **revenue expenditure** in the course of normal operations of business.

4) **Revenue expenditure;** excise duty on sugar manufactured is the cost incurred during the course of normal business operations or the cost incurred in order to earn income.
5) **Capital expenditure;** purchase of government loan is an investment which will be returned on due date.
6) **Capital expenditure;** as cost of construction of railway siding is for acquisition of a capital asset.

Question 7:

State which of the following expenses are capital, revenue and deferred revenues. Explain with reasons:

1) Expenditure incurred on overhauling machinery.
2) Taxes paid.
3) Wages paid to the workers for erection of a new machinery.
4) Cost of goodwill purchased.
5) Heavy expenditure incurred on advertisements.
6) Cost of construction of a building.
7) Machinery costing ₹ 10,000 sold for ₹ 12,000.
8) Purchased marketing rights of IPL IV for ₹ 15,00,000.

Solution:

1) **Revenue expenditure;** as expenditure incurred on overhauling machinery helps to maintain the machinery in working condition.
2) **Revenue expenditure;** if taxes are on goods purchased e.g. excise or sales tax. (Income tax is treated as drawings or capital expenditure).
3) **Capital expenditure;** wages paid to workers for erection of a new machinery are capitalised as all costs till an asset is installed are added to its cost as per Accounting Standard 10.
4) **Capital expenditure;** as cost of goodwill is an acquisition of intangible asset.
5) **Revenue expenditure,** the heavy expenditure incurred on advertisements is revenue expenditure as it does not create any asset.
6) **Capital expenditure;** as cost of construction of a building helps to create a capital asset.
7) **Capital receipt;** as the amount of ₹ 10,000 is received on sale of a fixed asset. Profit on sale (₹ 2,000) is credited to the Profit & Loss A/c as an extra-ordinary item of income.
8) **Capital expenditure;** as it is an acquisition of an intangible asset.

Question 8:

Slate whether the following expenditure is a capital, revenue or deferred revenue expenditure. Give reasons:

1) Payment for purchase of goods.
2) Payment for purchase of stationery.
3) Payment for purchase of a car.
4) Payment for purchasing mining rights

5) Partial refund of capital to a partner.
6) Payment of a loan taken earlier.
7) Payment of salaries.
8) Wages for erection of machinery.

Solution:

1) **Revenue expenditure;** as expenditure incurred for purchase of goods is a direct product cost related to normal business activities incurred in order to earn income during the year.
2) **Revenue expenditure;** as purchase of stationery is cost of administration related to normal business activities incurred in order to earn income during the year.
3) **Capital expenditure;** as purchase of a car helps to create a capital asset.
4) **Capital expenditure;** as a new intangible asset is purchased.
5) **Capital expenditure;** as partial refund of capital to a partner reduces the liabilities of the concern.
6) **Capital expenditure;** as payment of a loan taken earlier reduces the liabilities of the concern.
7) **Revenue expenditure;** as salaries is cost of administration related to normal business activities incurred in order to earn income during the year.
8) **Capital expenditure;** as wages for erection of machinery is a direct cost incurred for acquiring an asset which is to be capitalised as per Accounting Standard 10.

Question 9:

State with reasons, whether you would consider the following as capital expenditure or revenue expenditure:

1) Professional fees paid in connection with acquisition of leasehold premises.
2) Compensation paid to a retrenched employee for loss of employment.

Solution:

1) **Capital expenditure;** as professional fees paid in connection with acquisition of leasehold premises is a direct cost incurred in connection with the acquisition of an asset to be added to the cost of that asset [Accounting Standard 10].
2) **Revenue expenditure;** as compensation paid to a retrenched employee for loss of is an administrative employment is an administrative employment expenditure incurred in the course of normal business activities. However, if the amount is heavy, it may be treated as Deferred Revenue Expenditure, as it is a non-recurring expenditure not in the normal course of business, which benefits the business for many years by way of reduction in salary.

Question 10:

State whether the following are Capital or Revenue. Give reasons for the same:

1) Customs duty paid on raw materials purchased.
2) Wages paid to carpenter for making furniture.
3) Sale of old machinery.
4) Term Loan taken from Bank.
5) Commission received on Sales.
6) Brokerage paid on Purchase of Land.

Solution:

1) **Revenue expenditure;** it is incurred on purchase of raw materials which is a normal recurring transaction. It does not create any capital asset.
2) **Capital expenditure;** it is paid to bring into existence a capital asset. It increases cost of the capital assets.
3) **Capital Receipt;** the amount received on sale of machinery is a capital receipt as it is not received from normal business transaction. The profit or loss on sale of machinery is a capital profit or capital loss.
4) **Capital Receipt;** the amount is received from non-recurring business transaction.
5) **Revenue Receipt;** it is received from normal business recurring transaction.
6) **Capital expenditure;** the amount is paid to bring into existence a capital asset.