

Question 11:

Explain with reasons whether the following expenses are capital, revenue or deferred revenue:

- 1) Purchase of old machinery for cash ₹ 1,00,000.
- 2) Interest paid ₹ 15,000 on Bank Overdraft.
- 3) Paid Audit Fees ₹ 10,000.
- 4) Paid fees ₹ 6,000 to the Association for 3 years.
- 5) Provided depreciation ₹ 20,000 on Furniture.
- 6) Paid Insurance premium ₹ 1,000.

Solution:

- 1) **Capital expenditure;** The benefit from machinery purchased will be available for many years.
- 2) **Revenue expenditure;** The expenditure is incurred for normal running of the business.
- 3) **Revenue expenditure;** It is a normal business expenditure.
- 4) **Revenue expenditure;** As no new asset is created, expenditure is fully written off.
- 5) **Revenue expenditure;** It is a normal expenditure for using the furniture.
- 6) **Revenue expenditure;** It is a normal business expenditure.

Question 12:

Classify with reason the following into Capital or revenue:

- 1) Legal expenses ₹ 3,000 in connection with collection of debts.
- 2) Premium ₹ 25,000 on issue of new shares.
- 3) Dividend and Interest ₹ 10,000 on investments.
- 4) Sales-tax collected from purchaser of goods.
- 5) Cost of carrying out an experiment to modify a product.
- 6) Repairs to keep the machinery in good working condition.
- 7) Cost of a lathe machine ₹ 50,000.

Solution:

- 1) **Revenue expenditure;** It is incurred in normal course of business to collect debts.
- 2) **Capital Receipt;** It premium is received on issue on new shares.
- 3) **Revenue expenditure;** It is received in ordinary course of business on investments.
- 4) **Capital Receipt (Liability);** The same has to be paid to Government.
- 5) **Revenue expenditure;** unless the expenditure involves acquisition of any tangible fixed asset (e.g. equipments) or an intangible asset (e.g. patent or know-how).
- 6) **Revenue expenditure;** it is incurred to maintain the machinery in good working condition not to improve its capacity.
- 7) **Capital expenditure;** Purchase of a lathe machine would increase revenue earning capacity.

Question 13:

Determine whether the following are Capital or Revenue (Give Reasons).

- (a) A sum of ₹ 10,000 paid for obtaining a license to carry on business.
- (b) A fine of ₹ 505 paid for contravening Municipal rules and regulations.
- (c) Productive wages of ₹ 50,000 paid for the month of December, 2004.
- (d) Umbrellas were purchased for the employees at the cost of ₹ 3,000.
- (e) A second hand typewriter was purchased for ₹ 1,200 and ₹ 500 were spent for bringing it into working condition.

Solution:

- (a) **Capital Expenditure:** A Sum of ₹ 10,000 paid for obtaining a license to carry on business is Capital Expenditure as it helps to start the business activity; it is an acquisition of an intangible asset which is a long term source of income.
- (b) **Revenue Expenditure:** A fine of ₹ 505/- paid for contravening Municipal rules and regulation is a Revenue Expenditure. It is usual in nature and does not create any assets.
- (c) **Revenue Expenditure:** Productive wages of ₹ 50,000 paid for the month of December 2004 is a Revenue Expenditure because it is incurred in the normal course of business and required for day to day production.
- (d) **Revenue Expenditure:** ₹ 3,000 spent on Umbrellas, purchased for employees is a Revenue expenditure. It does not create any assets and is normally spent once in a year. It is a business expenditure.
- (e) **Capital Expenditure:** Amount spent on purchase of Second Hand Typewriter ₹ 1200 and ₹ 400 on repairing it, so as to bring it in working condition. Both together ₹ 1,600 creates an assets. Hence it is a Capital Expenditure.

Question 14:

State with reasons the nature of following Expenses/Receipts

- (a) Sold 4% Government Securities (Investment) for ₹ 1,40,000.
- (b) Preliminary Expenses paid ₹ 42,000.
- (c) Carriage outward paid ₹ 40,000.
- (d) Import duty paid on purchase of Computer Equipment ₹ 85,000 to be used in the office.
- (e) Received ₹ 5,00,000 on the Issue of 5% Debentures.
- (f) Legal expenses ₹ 6,000 paid in connection with Purchases of Land.
- (g) Repairing charges ₹ 15,000 paid for keeping the machinery in working condition.

Solution:

- (a) **Capital Receipt:** Sold 4% Govt. Securities (Investment) for ₹ 1,40,000 is Capital Receipt as the amount of ₹ 1,40,000 is received on the sale of investment.

- (b) **Revenue Expenditure:** Preliminary Expenses paid ₹ 42,000 is Revenue Expenditure as it has not created any asset.
- (c) **Revenue Expenditure:** Carriage outward Paid ₹ 40,000 is Revenue Expenditure as it is incurred in normal business operations to earn income during the year.
- (d) **Capital Expenditure:** Import duty paid on purchase of computer equipment ₹ 85,000 to be used in the office is a Capital Expenditure as import duty paid on the purchase of computer equipment is a direct cost of acquiring a fixed assets which is to be capitalised.
- (e) **Capital Receipt:** Received ₹ 5,00,000 on the issue of 5% Debenture is Capital Receipt as amount has been received from issue of debentures in course of financing activity of the company.
- (f) **Capital Expenditure:** Legal Expenses ₹ 6,000 paid in connection with purchase of land is Capital Expenditure as legal expenditure paid in connection with acquisition of land is a direct cost incurred in connection with the acquisition of a fixed assets to be added to the cost of the assets is to be capitalised.
- (g) **Revenue Expenditure:** Repairing charges ₹ 15,000 paid for keeping the machinery in working condition is Revenue Expenditure incurred on repair of the machinery which helps to maintain it in working condition.

Question 15:

State whether the following items are Capital or Revenue together with brief reasons for your answer:

- 1) ₹ 51,000 received from an insurance company for suspension of business activities due to bomb blasts in the city.
- 2) A plant worth ₹ 7,00,000 is brought by proprietor for business activities.
- 3) A dealer in timber acquired wood worth ₹ 3,00,000 and made furniture out of it at a total cost of ₹ 3,75,000 and sold it to a customer for ₹ 4,50,000.
- 4) Incurred ₹ 1,00,000 on research of a new product which did not materialise.
- 5) Heavy repairs to the roof of the building ₹ 1,00,000 for protection against rains.
- 6) Carriage and freight paid for bringing machinery ₹ 12,000 to be used in factory for manufacturing purpose.
- 7) Payment of legal fees to advocate for preparation of Purchase Agreement of Land /Building Rs. ₹ 20,000.
- 8) Wages paid to workers ₹ 10,500 for erection of new machinery in own plant.

Solution:

- 1) It is a **Revenue Receipt** as it is in connection with suspension of business activities. It is concerned with operation.
- 2) It is a **Capital Expenditure** as it brings into existence new asset.
- 3) Purchase of timber for making furniture for sale is **Revenue Expenditure**. ₹ 4,50,000 received on sale of furniture is a Revenue Receipt.

- 4) It is a **Revenue Expenditure**. It should be written off.
- 5) It is a **Capital Expenditure** as it increases cost of building.
- 6) It is a **Capital Expenditure** asw it increases cost of machinery. It is capitalised.
- 7) It is a **Capital Expenditure**. It increases cost of land and building. It is capitalised.
- 8) It is a **Capital Expenditure**. It increases cost of new machinery. It is capitalised.