



INSTITUTE OF HOTEL MANAGEMENT BHUBANESWAR  
Est. By Ministry of Tourism, Government of India

# **CAPITAL AND REVENUE EXPENDITURE**

## **1. Capital expenditure:**

Capital expenditure **includes costs incurred on the acquisition of a fixed asset** and any subsequent expenditure that **increases the earning capacity of an existing fixed asset**.

The cost of acquisition not only includes the cost of purchases but also **any additional costs incurred in bringing the fixed asset into its present location and condition** (e.g. delivery costs).

Capital expenditure, as opposed to revenue expenditure, is generally of a one-off kind and its **benefit is derived over several accounting periods**. Capital Expenditure may include the following:

- Purchase costs (less any discount received)
  - Delivery costs
  - Legal charges
  - Installation costs
  - Up gradation costs
  - Replacement costs
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- Capital expenditure is the money spends on buying fixed asset or adding to their values.
- The assets are expected to provide benefits to the business for more than one accounting period.
- Purpose of this is to increase earning capacity or decrease cost.
- **These assets are used in the business and not for sale.**
- Purchase of land or costs of extension of exiting building are examples.

**It has the following characteristics.**

- 1) The amount involved in such expenditure is generally large.
- 2) Benefit is for more than one accounting year.
- 3) The expenditure is of non-recurring nature.

**Expenditure can be recognised as capital if it is incurred for the following purposes.**

- 1) An expenditure incurred for the purpose of acquiring long term assets (useful life is at least more than one accounting period) for the use in business to earn profits and not meant for resale, will be treated as a capital expenditure.

**Example: If a second hand motor car dealer buys a piece of furniture with a view to use it in business; it will be a capital expenditure. But if he buys second hand motor car, it will be revenue expenditure because he deals in second hand motor car.**

- 2) When expenditure is incurred to improve the present condition of a machine or putting an old asset into working condition.



**Example: If one buys a machine for 5,00,000 and pays Rs 20,000 as transportation charges and Rs 40,000 as installation charges, the total cost of machine comes Rs 5,60,000 or if a building is purchased for Rs 1,00,000 and Rs 5000 is spent on registration and stamp duty, the capital expenditure on the building stands at Rs 1,05,000**

- 3) If an expenditure is incurred to increase earning capacity of a business.  
**Example: Expenditure incurred for shifting the factory for easy supply of raw material.**
- 4) Preliminary expenses incurred before the commencement of business is considered capital expenditure.  
**Example: Legal charges paid for drafting the memorandum and articles of association of a company or brokerage paid to brokers, or commission paid to underwriters for raising capital.**
- 5) Expenditure on trademark, patent rights, goodwill is example of capital expenditure as this expenditure, give benefit for a very long period.

**Examples:**

- 1) Purchase of land, building, Machinery or furniture
  - 2) Cost of leasehold land and building
  - 3) Cost of acquisition of long-term rights and benefits (E.g. Patents, copyrights)
  - 4) Preliminary expenditures
  - 5) Cost of addition or extensions to existing asset.
  - 6) Cost of overhauling second-hand machine
  - 7) Expenditure on putting an asset into working condition.
  - 8) Cost incurred for increasing the earning capacity of a business.
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**Some more examples:**

- 1) A new machine is purchased at Rs 20,000. The estimated life of it is 10 years.
- 2) Expense on purchase of a new machine. Installation charges of the above machine
- 3) Repair to furniture purchased second hand.
- 4) Expenses on construction of a new building.
- 5) Paid a bill of Rs 10000 of Mr. Kumar who was engaged as the erection engineer to set up a new automatic machine costing Rs 20,000 at the new factory site.
- 6) In accordance with the long-term plan of providing a well-equipped labour welfare, spent Rs 90,000 being the budgeted allocation for the year 1997.
- 7) An extension of railway tracks in the factory area.
- 8) Installation cost of new production machine.
- 9) Materials for extension to foremen's offices in the factory.
- 10) Purchase of a new computer for use in the business.
- 11) Freight and cartage on the new machine Rs 150 and erection charges Rs 500.
- 12) Rs 8200 spent on repairs before using a second hand car purchase recently, to put it in useable condition.
- 13) Rs 350 was spent on repairing a second hand machine which was purchased on 8<sup>th</sup> July 1998 and Rs 200 was paid on carriage and freight in connection with its acquisition.



- 14) Rs 18000 interests had accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries, however the production has not commenced till the last date of accounting year.
- 15) Rs 70000 spent for constructing railways siding.
- 16) Expenses incurred in connection with obtaining a licence for starting the factory were Rs 10000
- 17) A factory shed was constructed at a cost of Rs 1, 00,000. A sum of Rs 5000 had been incurred for the construction of the temporary huts for storing building material.
- 18) The installation of new wine bar for Rs 10,000.
- 19) The building of an extension of the club dressing room for Rs 15000
- 20) The purchase of VCR and TV for the use in the club lounge for Rs 15,000.
- 21) Registration expenses incurred for the purchase of land.
- 22) Repairing charges paid for remodelling the purchase old building.
- 23) Wages paid for erection of a new machine Rs 500
- 24) Purchase machinery Rs 20000.
- 25) Charges for bringing the machinery Rs 3000.
- 26) Wages paid for installation of the machinery Rs 600
- 27) Rs 2000 spent on demolition of a building to construct a bigger building on the same site.
- 28) Cost of removing a shop to a better situated premises.
- 29) A firm constructed a small temporary garage for the vehicles spending Rs 12000. The garage is to be demolished within a period of 3 years after permanent garage is ready.
- 30) A new machine is purchased for Rs 40000. An amount of Rs 3000 is spent on its erection in the factory .Rs 1200 are paid for octroi duty to bring the machine to town .Some of the firms workers worked on the erection job and their wages Rs 7000.
- 31) Purchase of Xerox machine for use in own office from business equipment suppliers ltd.
- 32) Repair done to second hand furniture purchased.
- 33) Cost of pucca water drains constructed on the land.
- 34) Rs 10000 spend towards addition to the machinery.
- 35) Rs 400 wages paid in connection with the erection of new machinery.
- 36) Second hand motor car purchased for Rs 20,000 and spent Rs 2000 for repairs immediately.
- 37) Legal expenses Rs 5000 incurred for purchasing a land.
- 38) A second hand truck was purchased for Rs 50,000 and Rs 12000 was spent on overhauling.
- 39) Rs 4750 were expended on dismantling, removing and reinstalling plant, machinery and fixtures.

## 2. Revenue Expenditure

Revenue expenditure incurred on fixed assets include costs that are aimed at **'maintaining' rather than enhancing the earning capacity of the assets.**

These are costs that are **incurred on a regular basis** and the **benefit from these costs is obtained over a relatively short period of time.**

For example, a company buys a machine for the production of biscuits. Whereas the initial purchase and installation costs would be classified as capital expenditure, any **subsequent repair and maintenance charges incurred in the future will be classified as revenue expenditure.**



This is so because repair and maintenance costs do not increase the earning capacity of the machine but only maintains it (i.e. machine will produce the same quantity of biscuits as it did when it was first put to use).

Revenue costs therefore comprise of the following:

- Repair costs
- Maintenance charges
- Repainting costs
- Renewal expense

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- Revenue Expenditure is the money spent on running the business on a day to day basis.
  - It is incurred to carry on the normal course of business and maintain the fixed assets in good condition.
  - **Revenue expenditure is for the current accounting period only.**
  - **It is incurred in the process of earning of the profit.**
  - Example: Salaries paid to the employees and payment for miscellaneous expenses.

**It has the following characteristics.**

- 1) The amount involved in such expenditure is relatively small.
- 2) The benefit accruing from such expenditure is available for one accounting period only.
- 3) The expenditure is of recurring nature.

**Rules for determining revenue Expenditure.**

- 1) Expenditure for day-to-day conduct of the business, the benefit of which last less than one year.  
**Example: wages of workmen, interest on borrowed capital, rent, selling, expenses and so on.**
- 2) Expenditure on consumable items, on goods and services for resale either in their original or improved form.  
**Example: Purchase of raw material, office stationery.**
- 3) Expenditure incurred for maintaining fixed assets in working order.  
**Example: Repairs, Renewals and depreciation.**

**Examples:**

- 1) Salaries and wages paid to employees.
- 2) Rent & rates for the factory or office premises.
- 3) Depreciation on plant & machinery.
- 4) Consumable stores.
- 5) Inventory of raw materials, work-in progress and finished goods.
- 6) Insurance perineum.
- 7) Miscellaneous expenses.
- 8) Depreciation charged on assets.



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- 9) Bad debts declared by the debtors during the accounting period.
  - 10) All other office expenses for the maintenance of business.
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### Some More examples.

- 1) Payment for repair of the machine to keep it in working condition.
- 2) Wages paid to the machine operator.
- 3) Electricity cost required to run the machine.
- 4) Incurred Rs 26,000 expenditure on various advertisement campaigns undertaken yearly, on a regular basis, during the peak festival season.
- 5) Wages paid to machine operator.
- 6) Rent paid to the factory.
- 7) The use of motor vehicle, hired for 5 years, but paid at every six month.
- 8) A sum of Rs 400 was spent on painting the factory.
- 9) A sum of Rs 500 was paid as compensation to two employees who were retrenched.
- 10) Rs 150 were paid in connection with carriage on goods purchased.
- 11) Rs 5000 paid as contribution to PWD for improving roads of sugar producing area.
- 12) The purchase of wine and spirits Rs 2000.
- 13) Rs 1000 paid for removal of stock to new site.
- 14) Repairing for the machinery Rs 1500.
- 15) Rs 15000 were paid as compensation to a discharged employee.
- 16) Damage paid on account of the breach of a contract to supply certain goods.
- 17) Stock of goods destroyed in an accident during the machine is in operation.
- 18) Payment of carriage on goods purchase paid by cheque.
- 19) Purchase of packing material for distribution of goods from Andhra Pradesh paper mill Ltd.
- 20) Rs 1500 spent to remove a worn out part and replace it with a new one.
- 21) Rs 1000 was spent for whitewashing the factory building
- 22) The removal of stock from the old work to the new one costs Rs 500.
- 23) Outstanding Rent, Salary, Interest.
- 24) Paid by cheque for purchasing goods (raw material) for manufacturing goods.

### 3. Deferred Revenue Expenditure.

- Deferred Revenue Expenditures are those expenditures which have been **incurred in an accounting period** and they do not **create any assets** but their **benefit is spread in more than one accounting period**
- It is incurred during a particular accounting period but is applicable either wholly or in part to future accounting periods.



- Example: When a new firm enters into market, it undertakes special advertising campaign on which it spends a very heavy amount, i.e. Rs 5, 00,000 in 2003 and its benefit is expected over next 5 years. This expenditure will be written off over 5 years @Rs 100,000 per year.
- **Examples**
  - 1) Discount on issue of shares and debentures,
  - 2) Heavy expenditures on marketing of product,
  - 3) Image building,
  - 4) Repairing and painting of building

### Features of Deferred Revenue

- 1) It is a part of revenue expenditure and has no connection with capital expenditure.
- 2) Benefits from such expenditure are received only during a few subsequent accounting period.
- 3) The **usefulness cannot be measures**.

### Other Examples are:

- 1) Rs 10,000 were spent on advertisement, the introduction of a new product in the market, the benefit of which will be effective during 4 years.
- 2) The redecoration expenses Rs6000.
- 3) Rs25000 spent in searching for a new product but it did not result in any success.
- 4) Cost of special advertisement undertaken for the purpose of introducing a new product.
- 5) The building got painting and involved a huge expenditure.
- 6) Expenditure incurred on R & D.

### Distinction between Capital Expenditure and Revenue Expenditure.

Distinction between Capital Expenditure and Revenue Expenditure.		
Basis	Capital Expenditure	Revenue Expenditure
Purpose	It is incurred for acquisition of fixed assets for the use in business	It is incurred for running of business
Period	It increases earning capacity of the business	It is incurred for earning profits
Debited	It is debited to an Assets Account	It is debited to an Expense Account
Nature of Accounts	It is an Assets Account	It is an expense Account
Depiction	It shows in the Balance Sheet	It shown in the Trading or Profit and Loss Account
Examples	a) Cost of Plant & Machinery	a) Depreciation on Plant & Machinery
	b) Cost of Land & Building	b) Rent
	c) Cost of Furniture and Fixtures	c) Repairs on Insurance

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