St. Lawrence High School

A Jesuit Christian Minority Institution

Study Material 6

Sub: ACCOUNTANCY Class 11

Chapter: Unit 1: Introduction to Accounting Date: 06/07/2020

Topic: Basic Accounting Terms 2

Basic Accounting Terms

Capital and Revenue Receipts:

A receipt of money may be capital or revenue in nature. A clear distinction, therefore, should be made between capital receipts and revenue receipts.

A receipt of money is considered as capital receipt when a contribution is made by the proprietor towards the capital of the business or a contribution of capital to the business by someone outside the business. Capital receipts do not have any effect on the profits earned or losses incurred during the course of a year. Capital receipts can take one or more of the following forms:

1. Additional capital introduced by the proprietor; by partners, in case of a partnership firm, by Issuing fresh shares, in case of a company; and,
2. By selling assets, previously not intended for resale

Any receipt of money is considered as revenue receipt when it is received from customers for goods supplied, or fees received for services rendered in the ordinary course of business, which is a result of the firm's activity of the current period. Receipts of money in the revenue nature increase the profit or decrease the losses of a business and must be set against the revenue expenses in order to ascertain the profit for the period.

Capital Expenditure:

Capital expenditure is the money spent on buying fixed assets or adding their value. These assets are expected to provide benefits to the business for more than one accounting period. Purchase of land or cost of extensions of existing building are examples of capital expenditure. Capital expenditure is debited to the fixed asset accounting which appears on the balance sheet. Therefore, it is an expenditure on assets which is not written off completely against income in the accounting period in which it is incurred.

A capital expenditure has the following characteristics:

(1) The amount involved in such expenditure is generally large;

(2) The benefit accruing from such an expenditure is available for than one accounting period;

(3) The expenditure is non-recurring in nature.

Some examples of capital expenditure

(1) Purchase of land, building, machinery or furniture;

(2) Cost of leasehold land and building:

(3) Cost of additions or extensions to existing assets;

(4) Cost of overhauling second hand machines;
(5) Expenditure on putting an asset into working condition; and
(6) Cost incurred to increase the earning capacity of a business.

Revenue Expenditure:
Revenue expenditure is the money spent on running the business on a day-to-day basis. Salaries paid to the employees and payment for miscellaneous expenses are the example of revenue expenditure. Therefore, a revenue expenditure is incurred to carry on the normal of business and maintain the fixed assets in good condition. Since a revenue expenditure is of the benefit for the current accounting period only, it is debited to an expense account which is ultimately transferred to the Profit and Loss Account.
A revenue expenditure 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.
Some examples of revenue expenditure
(1) Salaries and wages paid to the employees;
(2) Rent and rates for the office premises;
(3) Depreciation on plant and machinery;
(4) Consumable stores;
(5) Inventory of raw materials, work-in progress and finished goods;
(6) Taxes and legal expenses; and
(7) Miscellaneous expenses.

Deferred Revenue Expenditure:
Deferred revenue expenditure is a revenue expenditure whose usefulness extends over more than one accounting period. It can be defined as that class of revenue expenditure which is incurred during a particular accounting period, but is applicable either wholly or in part to future accounting periods. Sometimes a business unit may take some revenue expenditure but is eventually becomes an asset. In the early years of a business, it may be necessary to spend a considerable amount of money on advertising or on research and development. There is usually a time gap between the expenditure incurred and the usefulness that is provides. The treatments of these expenditures is precisely the same as the treatment of fixed assets. Though it is of a revenue nature, it is spread over and written off in several years. Therefore, it is proper to charge only a part of the total revenue expenditure to the current year's profit and loss account as an expense. The balance is carried forward as deferred revenue expenditure to be written off in the subsequent years.

Expenses:
Expenses represents the cost of the goods and services used up or consumed in the process of earning revenue during a particular accounting period. An expense may be represented by a cash payment, e.g., wages, or by incurring a liability, e.g., outstanding rent. Alternatively, it may be calculated as a portion of the value of a fixed asset, i.e., depreciation, or as an amount written off a current asset, e.g., bad debts.

An expense never includes items like drawings by the owner, repayment of loan principal or asset acquired having future value to the business unit. Since an expense is an expired cost, it no longer represents an asset to the business unit. An expense is shown as charge against profit in the Trading and Profit & Loss Account.

Income:

Income is the excess of business entity's revenues over its expenses during an accounting period. Income refers to the increase in wealth. A business entity commences activities in the attempt to increase its net wealth. A business entity commences activities in the attempt to increase its net assets through profitable operations. This increase in net asset is referred to as the income of the firm. Income is taken to be measure of the success of a business unit. Thus, the concept of income and its measurement are central of accounting.

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