

Accounting for Capital & Revenue Expenditure/Receipts, Accruals & Prepayments

Capital & Revenue Expenditure

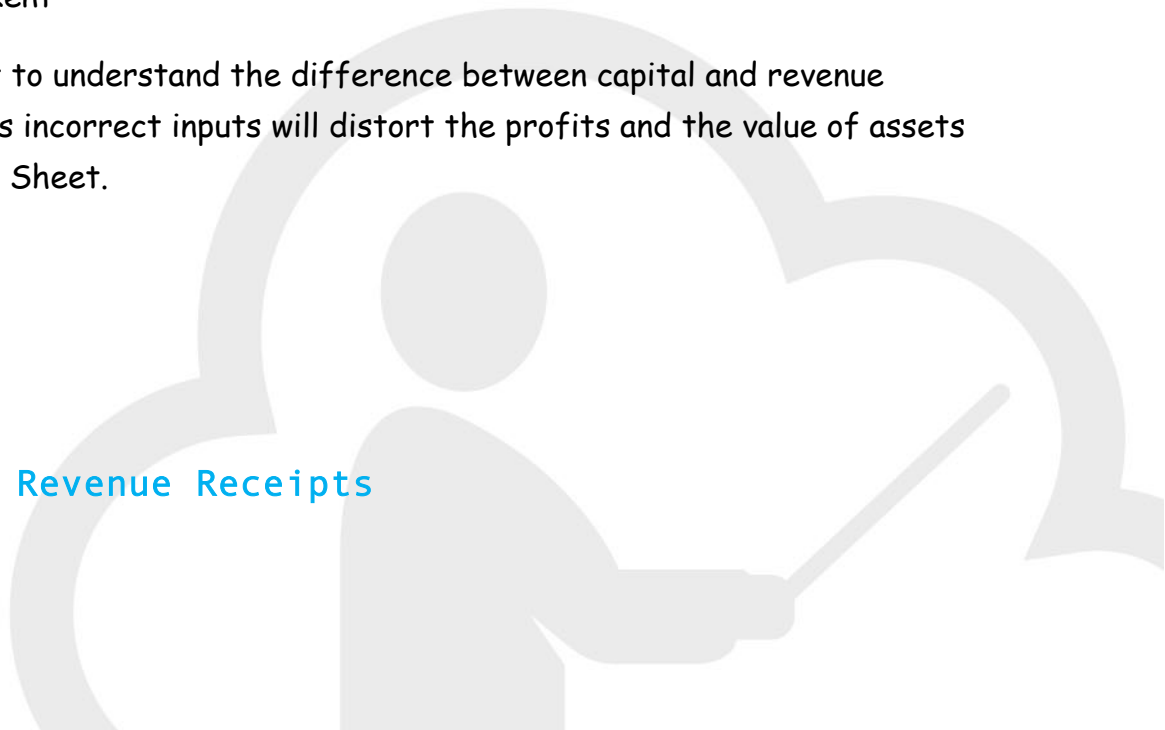
Business expenditure falls into 2 classifications. This classification determines whether it ends up in the Profit & Loss Account (finds profit or loss) or in the Balance Sheet (assets and liabilities after profit and loss).

These classifications are;

- **Capital expenditure** - This is entered into the Balance Sheet. It is money we spend when purchasing or improving a fixed asset which increases its earning capacity e.g.
 - Purchase of buildings
 - Improvement of extension of buildings
- **Revenue expenditure** - This is entered into the Profit and Loss Account and refers to the day to day running costs of a business. It is money we spend in the running of the business during the accounting period e.g.
 - Wages
 - Rent

It's important to understand the difference between capital and revenue expenditure as incorrect inputs will distort the profits and the value of assets in the Balance Sheet.

Capital & Revenue Receipts



Business receipts fall into 2 classifications. This classification determines whether it ends up in the Profit & Loss or in the Balance Sheet.

These classifications are;

- Capital receipts - These are receipts that come from sources other than normal trading in the business e.g.
 - The sale of fixed assets
 - Bank loans
 - Grants

- Revenue receipts - These are receipts that come from the day to day transactions of the business e.g.
 - Sales of stock
 - Rent received
 - Investment income

It's important to understand the difference between capital and revenue receipts as incorrect inputs will again distort the profits and the value of assets in the Balance Sheet.

Accruals & Prepayments

When we are preparing a trading and profit and loss account, a business must include **only** items of income and expense that apply to that accounting period. **Accruals** (amounts due) must be included in the accounts and are added onto the income or expense.

Prepayments, which are paid into the next accounting period, shouldn't be included in this year's accounting period; we then subtract them from the income or expense.

Receipts such as rent receivable or commission receivable may be in advance or in arrears at the end of the accounting period.

All unpaid revenue expenses in the accounting period such as rent due should be added to the payments already made in respect of that period. Equally all prepayments made during the accounting period should be deducted.

Examples

Accruals

Accruals refer to amounts due to be paid by a company but not yet paid. Let's take a look at an example.

Q 3.1

The rent payable on John Smith's premises is €8,000 per annum. This rent falls due at the end of each three-monthly period. He pays €2,000 on 31 March, 30 June, 30 September and 31 December. He made all the payments in 2010 as they became due except the payment due on 31 December.

You are asked to;

- Show the rent payable account for 2010
- Show the related journal entry transferring the correct charge to the profit and loss account on 31 December 2010.
- Relevant extracts from the Profit & Loss Account and the Balance Sheet

Rent Payable Account					
Mar-31	Bank - Jan, Feb, Mar	€ 2,000.00	Dec-31	Profit & Loss Acc	€ 8,000.00
Jun-30	Bank - Apr, May, Jun	€ 2,000.00			
Sep-30	Bank - July, Aug, Sep	€ 2,000.00			
Dec-31	Balance c/d	€ 2,000.00			
		€ 8,000.00			€ 8,000.00
			Jan-01	Balance b/d	€ 2,000.00

Journal			
Dec-31	Profit & Loss	€ 8,000.00	
	Rent payable acc (being rent payable for the year transferred to the P&L)		€ 8,000.00

Profit & Loss Account		
Expenses:		
Rent	€ 8,000.00	

Balance Sheet		
Current Liability:		
Rent Due	€ 2,000.00	

The balance b/d in the rent account is due and is an unpaid payment for rent at the end of the year. As such it will be listed under Current Liabilities in the Balance Sheet as we were due to pay it.

Prepayments

Prepayments refer to the amounts paid in advance. Let's take a look at an example.

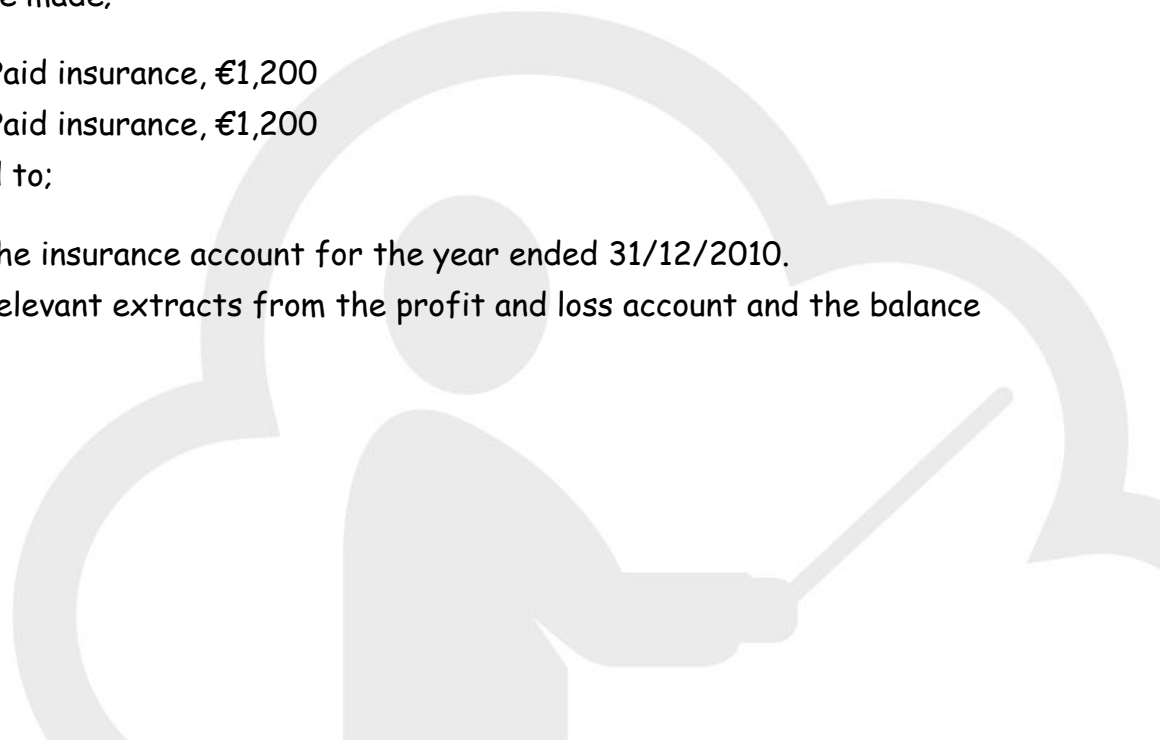
Q 3.2

A firm pays its insurance premium twice yearly in advance. The following payments were made;

Mar 31 Paid insurance, €1,200
 Sep 30 Paid insurance, €1,200

You are asked to;

- a) Show the insurance account for the year ended 31/12/2010.
- b) Show relevant extracts from the profit and loss account and the balance sheet.



Insurance Account					
Mar-31	Bank	€ 1,200.00	Dec-31	Profit & Loss Acc	€ 1,800.00
Sep-30	Bank	€ 1,200.00	Dec-31	Balance c/d	€ 600.00
		€ 2,400.00			€ 2,400.00
Jan-01	Balance b/d	€ 600.00			

Journal			
Dec-31	Profit & Loss	€ 1,800.00	
	Insurance account (being insurance for the year transferred to P&L)		€ 1,800.00

Profit & Loss		
Expenses:		
Insurance	€ 1,800.00	

Balance Sheet		
Current Assets:		
Insurance Prepaid	€ 600.00	

The insurance has been paid every six months. Three months (half) of the last payment has been paid into next year; as a result, the balance at the end of the year is €600. This is then listed as a Current Asset in the Balance Sheet.

Accrued Receipts

A company might have amounts due to its which are unpaid at the end of the accounting period, these are accrued receipts, let's take a look at an example.

Q 3.3

A company sublets part of its premises at a rent of €8,000 per annum. The rent falls due at the end of each three month period in arrears. The firm received payments as follows for the year ended 31/12/2010;

Mar 31	Received rent €2,000
Jun 30	Received rent €2,000
Sep 30	Received rent €2,000

You are required to show:

- The rent receivable account for year ended 31/12/2010
- Relevant extracts from both the profit and loss and the balance sheet

Rent Recievable for year ended 31/ 12/ 20 10					
			Mar-31	Bank	€ 2,000.00
			Jun-30	Bank	€ 2,000.00
			Sep-30	Bank	€ 2,000.00
Dec-31	Profit & Loss	€ 8,000.00	Dec-31	Balance c/d	€ 2,000.00
		€ 8,000.00			€ 8,000.00
Jan-01	Balance b/d	€ 2,000.00			

Profit & Loss for year ended 31/ 12/ 20 10		
Income:		
Rent receivable	€ 8,000.00	

Balance Sheet as at 31/ 12/ 200 8		
Current Asset s:		
Rent receivable due	€ 2,000.00	

The balance of €2,000 in our RR Acc. is an unpaid receipt for rent at the end of the year and as such is listed as a Current Asset in our Balance Sheet.

Prepaid Receipts

Sometimes amounts are paid in advance to the firm. These are called prepaid receipts; let's take a look at an example.

Q 3.4

If we take a look at the previous question and the Sep 30 receipts of rent were €6,000 instead of €2,000, we would have received €2,000 in advance by Dec 31. Complete the question then using information from Q 3.3.

You are required to show;

- The rent receivable account for year ended 31/12/2010
- Relevant extracts from both the profit and loss and the balance sheet

Rent Receivable Account for year ended 31/12/2010					
Dec-31	Profit & Loss	€ 8,000.00	Mar-31	Bank	€ 2,000.00
	Balance c/d	€ 2,000.00	Jun-30	Bank	€ 2,000.00
			Sep-30	Bank	€ 6,000.00
		€ 10,000.00			€ 10,000.00
			Jan-01	Balance b/d	€ 2,000.00

Profit & Loss for year ending 31/12/2010		
Income:		
Rent receivable	€ 8,000.00	
Balance Sheet as at 31/12/2010		
Current Liability:		
Rent prepaid	€ 2,000.00	

The balance of €2,000 on Jan 1 2011 is a current liability and will be listed under Current Liabilities in our Balance Sheet as it was NOT due to us in 2010.

Homework

Now take a look at the following question and complete it yourself.

Q 3.5

A business sublets its premises for a yearly rent of €10,000. The business received the following payments during the year ended 31/12/2008.

Mar 31	Received rent €2,500
Jun 30	Received rent €2,500
Sep 30	Received rent €2,500

You are asked to show;

- The rent receivable account for the year ended 31/12/2008.

b) Relevant extracts from the Profit and Loss Acc. and the Balance Sheet for 2008.

Rent Receivable Account for year ended 31/12/2008					
				Mar-31	Bank € 2,500.00
				Jun-30	Bank € 2,500.00
				Sep-30	Bank € 2,500.00
Dec-31	Profit i & Loss	€ 10,000.00		Dec-31	Balance c/d € 2,500.00
		€ 10,000.00			€ 10,000.00
Jan-01	Balance b/d	€ 2,500.00			

Profit & Loss		
Income:		
Rent receivable	€ 10,000.00	

Balance Sheet		
Current Asset:		
Rent receivable due	€ 2,000.00	

