

## Assets versus liabilities and capital versus revenue

In this module we are going to look at two separate accounting ideas.

- The first is the distinction between **assets** and **liabilities**. We must be able to understand these accounting terms and be able to identify examples of each.
- The second is the distinction between **capital** and **revenue** income and expenditure.

### Assets and liabilities

Simple definitions of these terms are as follows:

- **assets** are items owned by the business and money owed to the business
- **liabilities** are amounts owed by the business to other organisations or people

Assets and liabilities can be thought of as the opposite of each other. The accounting equation that states that:

$$\text{assets} - \text{liabilities} = \text{capital}$$

confirms this idea, by deducting liabilities from assets to arrive at the value of the business.

There is more information on the accounting equation and how it is used in the study module *Accounting equation and basic posting*.

Examples of assets are:

- Buildings
- Equipment
- Inventory (items to be used in manufacture or to be sold)
- Trade receivables (amounts owed to the business by credit customers)
- Money in the bank
- Money held in cash

Examples of liabilities are:

- Trade payables (amounts owed by the business to credit suppliers)
- Loans (either from a bank or another organisation)
- Bank overdraft

Have a look at the following list and decide which items are assets and which are liabilities, before clicking the icon to see the answer.

Item	Asset	Liability
A loan to the business from Simply Loans Ltd		<input type="checkbox"/>
A van bought by the business	<input type="checkbox"/>	
Money in the business petty cash box	<input type="checkbox"/>	
An amount owed by the business to Super Supplies Ltd for goods purchased on credit		<input type="checkbox"/>
Components bought by the business ready to make into items to sell	<input type="checkbox"/>	
An amount owed to the business by Fox and Sons, who bought some goods on credit	<input type="checkbox"/>	

Click to display/hide the solution.

## Capital and revenue

In this area we need to understand and be able to identify:

- Capital income
- Revenue income
- Capital expenditure
- Revenue expenditure

This means that we must be clear about the distinction between income and expenditure as well as the difference between the terms capital and revenue.

**Income** relates to receiving money (or other value) often because goods, other assets or services have been sold. These are the 'incoming' amounts of the business.

**Expenditure** relates to buying things or incurring costs – either by immediate payment or in other ways (for example by purchasing on credit). These are sometimes called 'outgoings' because of the direction that the money is normally flowing.

Let's now look at the terms 'capital' and 'revenue' and see what these terms mean – firstly when describing expenditure, and then when linked to income.

**Capital expenditure** is expenditure incurred to:

- purchase
- alter
- improve

an asset that will be used in the business for a long period (more than one accounting period). Such assets are called non-current assets.

Examples of non-current assets are:

- land and buildings
- vehicles
- equipment.

Capital expenditure is the cost of first bringing the asset into use, together with any later alterations or improvements. The initial costs would therefore include:

- purchase costs
- installation costs
- legal costs relating to the purchase.

Note that while the cost of an improvement to an asset is capital, the cost of simply repairing an asset is not. A repair is when the asset is brought back to its previous condition – but not improved.

**Revenue expenditure** relates to the costs of running the business. Purchases of consumable items and services are revenue items, as well as items bought for manufacture or trading. Examples include: fuel for vehicles, insurance costs and payment of wages. Regular tax payments could also be considered revenue expenditure.

Have a look at the following list of expenditure items and decide which ones are capital and which are revenue, before clicking the icon to see the answer.

Expenditure item	Capital expenditure	Revenue expenditure
Cost of paying the office manager's salary		<input type="checkbox"/>
A van bought by the business	<input type="checkbox"/>	
The cost of building an extension to the office building	<input type="checkbox"/>	
Travelling expenses paid through petty cash		<input type="checkbox"/>
Components bought by the business ready to make into items to sell		<input type="checkbox"/>
The cost of repairing the roof of the factory		<input type="checkbox"/>

Click to display/hide the solution.

We will now look in more detail at the other pair of terms: capital income and revenue income.

**Capital income** is income received from non-regular (one-off) transactions. The main example is the income generated from the sale of non-current assets. Other examples are loans received by the business and capital invested in the business by the owner or owners of the business.

**Revenue income** is generated from regular transactions made by the business. The main example is sales income. Other examples are:

- rental income
- commissions receivable
- prompt payment discounts
- receipts from taxes (for example VAT refunds).

Let's look at the following list of income examples. Decide which ones are capital and which are revenue before clicking the icon to see the answer.

Income item	Capital income	Revenue income
Income from renting out a warehouse		<input type="checkbox"/>
Money received from the sale of a car owned by the business	<input type="checkbox"/>	
Money received from a bank loan taken out by the business	<input type="checkbox"/>	
Income generated by a manufacturing business from selling goods that it had made		<input type="checkbox"/>
Interest received from a bank deposit account		<input type="checkbox"/>
Income from a shop from selling goods that were purchased for resale		<input type="checkbox"/>

Click to display/hide the solution.

Finally, have a look at the following examples of both income and expenditure, and decide how they should be analysed, before clicking the icon to see the solution.

Income item	Capital income	Revenue income	Capital expenditure	Revenue expenditure
Cost of paying employers' National Insurance contributions				<input type="text"/>
Receipt of £20,000 investment into the business from the owner	<input type="text"/>			
The cost of converting part of a warehouse into offices			<input type="text"/>	
The cost of redecorating the staff canteen				<input type="text"/>
Purchase of goods for resale				<input type="text"/>
Receipt of royalties relating to a design owned by the business		<input type="text"/>		

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