

Capital and revenue expenditure and receipts

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Read first: [The double entry system of book-keeping](#), [The accounting equation](#)

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What you need to know

By the end of this topic you should be able to:

1. **Tell capital expenditure from revenue expenditure, and record each one correctly.** Capital expenditure goes to a non-current asset account and the statement of financial position; revenue expenditure goes to an expense account and the income statement.
2. **Tell capital receipts from revenue receipts, and record each one correctly.** Revenue receipts are income in the income statement; capital receipts are not income at all.
3. **Work out, and comment on, how a wrong classification changes the profit for the year**, including the knock-on effect on depreciation and on gross profit.
4. **Work out, and comment on, how a wrong classification changes the value of assets** (mainly non-current assets at cost and at net book value) in the statement of financial position.

Depreciation methods and disposal accounts are the next topic. Here you only need depreciation to see how an error in the cost of an asset changes the depreciation charge.

Understand it

Two kinds of spending

Every payment a business makes is one of two kinds.

- **Capital expenditure** is money spent on **buying, improving or extending non-current assets**: assets the business keeps and uses for more than a year, such as premises, machinery, vehicles, fixtures and computers. The benefit lasts for several years, so the cost is **not** an expense of this year. It is debited to the asset's account and shown in the **statement of financial position**; only the depreciation on it reaches the income statement, a slice at a time.
- **Revenue expenditure** is money spent on **running the business from day to day**, including keeping non-current assets working as they are. The benefit is used up within the year, so it is debited to an expense account and charged in full to the **income statement**, where it reduces profit.

A useful test: *after the spending, does the business have a new asset, or an asset that is bigger or better than before?* If yes, it is capital. If the spending only keeps things as they were, or is used up in the year, it is revenue.

Costs of getting an asset ready to use

The cost of a non-current asset is **everything it takes to get the asset into place and working**, not just the price on the invoice. All of these are capital expenditure and are added to the asset's cost:

- the purchase price;
- delivery or carriage charges on the asset;
- installation, fitting and the wages of the business's own staff while they install it;
- legal fees when buying premises, or for permission to build;
- building an extension, and decorating or equipping it before it is first used (painting a **new** extension, shelving and light fittings in a new storage area);
- improvements that make an asset better than it was (a roof rack fitted to a van, an alarm system in a new warehouse).

The costs of **using** and **keeping** the asset are revenue expenditure: insurance, fuel, electricity, rates, road tax, servicing, repairs, replacing worn parts (tyres, light bulbs), and redecorating premises the business already uses.

The same activity can fall on either side. Painting a **new** extension is part of making it ready, so it is capital; repainting a shop the business has used for years is upkeep, so it is revenue. Always ask what the spending is **for**.

Materiality

Some items last for years but cost so little that listing them as non-current assets and depreciating them would cost more effort than it is worth: a \$12 stapler or a waste bin. Under the **materiality** principle these are treated as revenue expenditure. What counts as "small" depends on the size of the business: an amount that is material for a corner shop may not be for a large company.

Two kinds of money received

- **Revenue receipts** come from the **normal trading and running** of the business: sales of goods or services, rent received, commission received, interest received and discount received. They are income, so they go to the income statement and increase profit.
- **Capital receipts** come from **anything else**: capital introduced by the owner, money from issuing shares, a loan received, and the proceeds from selling a non-current asset. None of these is income, so none of them goes into the profit. They are recorded in the statement of financial position (capital, share capital, a liability) or, for the sale of an asset, in the disposal account, where only the **gain or loss** on disposal reaches the income statement.

What matters is whether selling the item is the business's normal trade. A bakery selling its old delivery van has a capital receipt, because it is not in the business of selling vans. A car dealer selling cars from its showroom has revenue receipts, because those cars are its inventory.

How each item is recorded

Item	Debit	Credit	Where it ends up
Capital expenditure, e.g. new machine paid by cheque	Machinery	Bank	Statement of financial position (cost, less depreciation)
Capital expenditure on credit, e.g. new equipment	Equipment	The supplier	Statement of financial position
Revenue expenditure, e.g. repairs paid in cash	Repairs	Cash	Income statement (expense)
Revenue receipt, e.g. commission received	Bank	Commission received	Income statement (income)
Capital receipt: owner puts in more money	Bank	Capital	Statement of financial position (capital)
Capital receipt: loan received	Bank	Loan	Statement of financial position (liability)
Capital receipt: proceeds of selling an asset	Bank	Disposal	Only the gain or loss goes to the income statement

A non-current asset bought on credit is **never** entered in the purchases account or the purchases journal: "purchases" means goods bought for resale. Its journal entry is debit the asset account, credit the supplier, with a narrative such as "Purchase of equipment on credit".

Why the split matters

Profit is income minus the expenses **of the year**. If the two kinds of spending or receipts are mixed up:

- the **profit** is wrong, so the owner may take out drawings the business cannot afford, pay tax on the wrong amount, and make decisions on false figures;
- the **statement of financial position** is wrong: non-current assets, capital or liabilities do not show what the business really owns and owes;
- lenders and investors are misled;
- the **matching** principle is broken (the cost of an asset should be spread over the years that benefit from it), and so is **prudence** when profit or assets are overstated.

The effect of a wrong classification

There are four possible mix-ups. Learn this table.

Error	Profit for the year	Non-current assets
Revenue expenditure treated as capital (e.g. repairs debited to the asset account)	Overstated (expenses too low)	Overstated
Capital expenditure treated as revenue (e.g. a new asset debited to an expense account)	Understated (expenses too high)	Understated
Capital receipt treated as revenue receipt (e.g. a loan credited to sales)	Overstated (income too high)	No change, but the matching item (loan, capital or the asset sold) is wrong
Revenue receipt treated as capital receipt (e.g. commission credited to capital)	Understated (income too low)	No change

Profit feeds into capital, so when profit is overstated, the owner's **capital** in the statement of financial position is usually overstated by the same amount (and understated when profit is understated). The exception is an error that also took the amount out of capital, such as capital introduced recorded as income: then the two effects cancel in the closing capital.

If the item went through the purchases or sales account, the **gross profit** is wrong as well as the profit for the year. A new machine debited to purchases makes cost of sales too high, so gross profit **and** profit for the year are both understated.

When depreciation is involved

Depreciation is worked out on the balance of the asset account, so an error in that balance also makes the depreciation wrong, and the depreciation partly cancels the error.

Suppose a repair of \$530 is wrongly debited to the equipment account, and equipment is depreciated at 10% a year on the year-end balance.

- Expenses are too low by the \$530 repair.
- Depreciation is too high by $10\% \times 530 = 53$.
- Net effect: profit is **overstated** by $530 - 53 = 477$.
- The equipment's net book value is also **overstated** by \$477: its cost is \$530 too high and its provision for depreciation \$53 too high.

The rule for a full year is **amount wrongly treated — depreciation charged on it**, and the profit and the net book value are wrong by the same figure, in the same direction. Read the question carefully: "ignore depreciation", "no depreciation in the year of purchase" or an asset such as land that is not depreciated all mean the whole amount affects profit.

Key facts and formulas

There is no formula list in the IGCSE Accounting exam, so everything here must be learnt.

Formula	Status
Cost of a non-current asset = price + delivery + installation + legal fees + any other cost of getting it ready for use	Learn it
Capital expenditure → asset account (statement of financial position); revenue expenditure → expense account (income statement)	Learn it
Revenue receipts → income statement; capital receipts → capital, liabilities or the disposal account	Learn it
Revenue expenditure treated as capital: profit overstated, non-current assets overstated	Learn it
Capital expenditure treated as revenue: profit understated, non-current assets understated	Learn it
Capital receipt treated as revenue: profit overstated; revenue receipt treated as capital: profit understated	Learn it
Effect on profit (and on net book value) of a wrong classification with a full year's depreciation = amount – (rate × amount)	Learn it
Corrected profit = draft profit + each understatement – each overstatement	Learn it

How to do it

We have 47 tagged questions for this topic from 2021 to 2025 (35 different, as many appear on two or three paper variants): 37 one-mark multiple-choice questions from Paper 1 and 10 twenty-mark Paper 2 questions where this topic is one or more parts. 5 of the Paper 2 questions mix two or three types, so the counts add up to 53.

Question type	Questions
Effect of a wrong classification on profit and assets	24
Classify expenditure, or total the capital expenditure	17
Classify receipts	7
Define the terms and explain why the difference matters	5

1. Effect of a wrong classification on profit and assets (24 questions)

- Say what happened.** Name the kind of item (capital or revenue, expenditure or receipt) and how it was wrongly treated.
- Use the table in "Understand it"** to decide the direction: an expense left out of the income statement, or extra income put in, makes profit **overstated**; the opposite makes it **understated**.

3. **Adjust for depreciation** if the item went into (or should have gone into) an asset account that is depreciated: the effect is the amount less the depreciation charged on it.
4. **Several errors:** give each one a sign (+ if profit was understated, so the correction adds; – if overstated) and add them up. The net figure gives the overall effect; the corrected profit is the draft profit plus the net correction.
5. **Assets:** do the same for non-current assets. Only errors that went into, or should have gone into, an asset account change them.

For example, a new display freezer costing \$2 850 was debited to the maintenance account; equipment is depreciated at 20% a year on the year-end balance. Expenses are \$2 850 too high and depreciation is $20\% \times 2850 = 570$ too low, so profit is **understated** by $2850 - 570 = 2280$, and the equipment's net book value is understated by \$2 280.

Variations you will meet:

- **Direction only** ("overstated / understated" in a two-column table): no figures needed, just the table. Watch which column is which.
- **Revised profit** from a draft figure: the draft profit plus or minus each correction.
- **Wrong side of an account.** An asset credited to purchases instead of debited to the asset account reduces purchases, so profit is **overstated** by the amount.
- **Through purchases or sales.** An asset debited to purchases, or proceeds of selling an asset credited to sales, changes **gross profit** as well. A running cost debited to purchases (fuel, say) makes gross profit too low and that expense account too low.
- **Proceeds of selling an asset credited to sales.** Gross profit is overstated by the whole proceeds. The profit for the year is overstated by the proceeds less any gain on disposal that should have been included (or plus any loss that should have been charged).
- **A loan or extra capital recorded as income:** profit is overstated either way. For a loan, capital is overstated too and liabilities are understated. For extra capital, closing capital is unchanged: the profit added to capital is too high, but the capital introduced, which should have been credited straight to the capital account, is missing by the same amount.
- **A payment covering more than one year** (such as a two-year service contract) wrongly debited to an asset account: work out the correct expense for this year only (the rest is a prepayment) and compare it with the depreciation that was charged instead.
- **Depreciation named in the answer** ("cost of non-current assets understated, depreciation for the year understated"): when capital expenditure is expensed, the asset's cost is too low, so the depreciation worked out on it is too low as well.
- **Effect on book value** after a year's depreciation: amount less depreciation, as in the example above.

2. Classify expenditure, or total the capital expenditure (17 questions)

1. **For each item ask the test question:** does it create, improve or extend a non-current asset, or get one ready to use? Then it is **capital**. Does it keep things running or get used up this year? Then it is **revenue**.

2. **Check the tricky words:** *new* versus *existing* (painting a new extension is capital, repainting an existing shop is revenue); *installation*, *delivery*, *legal fees* on a new asset are capital; *insurance*, *fuel*, *repairs*, *replacement parts* and *maintenance* are revenue.
3. **In a tick table**, put exactly one tick per row.
4. **For a total** ("how much should be debited to the machinery account?", "by how much will non-current assets increase?"), add up only the capital items.

For example, a business buys a generator for \$7 120, pays \$215 to have it delivered and \$85 for the fuel to run it in its first week. The generator account is debited with $7120 + 215 = 7335$; the fuel is an expense.

Variations you will meet:

- **"Which item is capital expenditure?"** as a multiple choice. Rule out anything bought for resale (a computer bought by a computer shop to sell is purchases), depreciation (an expense), and repairs.
- **The amount charged to the income statement:** add up only the revenue items instead.
- **Record a non-current asset bought on credit:** a journal entry debiting the asset account and crediting the supplier, with a narrative. Never use the purchases account.
- **Materiality:** explain that a very cheap item that lasts for years may be treated as revenue expenditure, because recording and depreciating it would cost more than the benefit, and that what is material depends on the size of the business.

3. Classify receipts (7 questions)

1. **Ask where the money came from.** Selling what the business normally sells, or earning rent, commission, interest or discount, is a **revenue receipt**.
2. **Anything else is a capital receipt:** the owner's capital, issuing shares, a loan, or selling a non-current asset (whether at, above or below its book value).
3. **For a total**, add only the kind asked for.

For example, a garage receives \$880 for servicing customers' cars, and its owner pays in \$3 900 from her own savings. The \$880 is a revenue receipt; the \$3 900 is a capital receipt.

Variations you will meet:

- **A four-column tick table** mixing capital and revenue expenditure and receipts: decide first whether money is going out (expenditure) or coming in (receipt), then capital or revenue.
- **Credit sales** are still revenue receipts, even though no cash has been received yet.

4. Define the terms and explain why the difference matters (5 questions)

1. **Define** each term in one sentence (see Key facts): capital expenditure is spent on buying, improving or extending non-current assets; revenue expenditure is spent on the day-to-day running of the business; capital receipts come from sources other than normal trading; revenue receipts come from normal trading activities.

2. **Explain why the difference matters** with developed points, not just "the profit will be wrong": revenue expenditure goes to the income statement and capital expenditure to the statement of financial position; getting it wrong over- or understates profit **and** the value of non-current assets; the owner could then take drawings based on profit that was not earned, or make poor decisions; it breaks the matching principle.
3. **Statement-choosing multiple choice**: capital expenditure is spent on non-current assets and appears in the statement of financial position; running costs of non-current assets (such as repairs) are revenue expenditure, not capital.

Worked examples

The bold codes show where marks are earned, as in Cambridge mark schemes. The number is how many marks.

- **M1** method mark: for a correct method, even if the numbers slip.
- **A1** accuracy mark: for a correct answer; it needs the M mark before it.
- **B1** mark for a correct result on its own, with no method needed.

Example 1

Lindiwe runs a bakery.

(a) Complete the table by placing one tick in each row to show how each item should be classified. [6]

Item	Capital expenditure	Revenue expenditure	Capital receipt	Revenue receipt
(i) A new bread oven				
(ii) Electricity to run the ovens				
(iii) Cash from selling the bakery's old delivery bicycle				
(iv) Replacing a broken glass door in the existing shop				
(v) Fees received for running a bread-making class				
(vi) Additional capital paid in from Lindiwe's savings				

(b) Explain why Lindiwe must classify these items correctly when she prepares her financial statements. [2]

(a)

- (i) **Capital expenditure**: a new non-current asset used for years. **B1**
- (ii) **Revenue expenditure**: a running cost used up in the year. **B1**
- (iii) **Capital receipt**: selling a non-current asset is not normal trading. **B1**
- (iv) **Revenue expenditure**: it restores the shop to how it was; nothing is improved. **B1**
- (v) **Revenue receipt**: income earned from the business's activities. **B1**
- (vi) **Capital receipt**: money from the owner is capital, not income. **B1**

(b) Only revenue items go into the income statement, so a wrong classification over- or understates her profit for the year (**1**), and the non-current assets or capital in her statement of financial position would also be wrong, so she might take drawings based on profit she has not earned (**1**).

Example 2

Tomasz sells frozen food and buys a van to deliver it. In his first six months with the van he pays the following amounts.

	\$
Road tax for the year	310
Price of the van	17 450
Replacement tyre after a puncture	185
Refrigeration unit fitted to the van before first use	2 340
Fuel	95
Six-month service	245

(a) Calculate the amount that should be debited to the motor vehicles account. **[2]**

(b) Tomasz debits all six payments to the motor vehicles account. Ignoring depreciation, state the effect on his profit for the year and on his non-current assets. **[2]**

(a) Only the van and the refrigeration unit add to the non-current asset; the unit improves the van before it is used, so it is part of its cost. **M1**

$$17\,450 + 2\,340 = 19\,790$$

\$19 790 **A1**

(b) Road tax, the tyre, fuel and the service are revenue expenditure: $310 + 185 + 95 + 245 = 835$. Leaving them out of the income statement makes expenses \$835 too low, so profit is **overstated by \$835 (1)**, and the motor vehicles account is **overstated by \$835 (1)**.

Example 3

Oduya's draft profit for the year ended 30 September 2026 was \$41 760. He then found these errors.

1. Rewiring the new warehouse extension before it was first used, \$3 460, had been debited to the repairs account.
2. Commission received, \$760, had been credited to his capital account.
3. Repainting the existing shop front, \$1 180, had been debited to the premises account.
4. A new till for the shop, \$935, had been debited to the purchases account.

Ignore depreciation.

(a) Calculate the corrected profit for the year. **[5]**

(b) Calculate the amount by which the non-current assets were understated or overstated before the errors were corrected. **[2]**

(a)

	\$
Draft profit for the year	41 760
Add: rewiring the new extension is capital, not an expense	3 460
Add: commission received is income	760
Less: repainting an existing shop is an expense	(1 180)
Add: the till is capital, not purchases	935
Corrected profit for the year	45 735

B1 for each of the four adjustments with the correct sign, **B1** for the corrected profit (own figure).

The till error also made cost of sales \$935 too high, so the **gross profit** was understated by \$935 as well.

(b) Rewiring +3460, repainting –1180, till +935: $3460 - 1180 + 935 = 3215$. **M1** The commission does not affect assets. The non-current assets were **understated by \$3 215**. **A1**

Example 4

Priya's year ends on 31 December 2026. On 1 January 2026 she bought a packing machine for \$8 650, which was correctly debited to the machinery account. She also paid:

- \$1 140 to have the machine installed, which was debited to the wages account;
- \$355 for a year's insurance on the machine, which was debited to the machinery account.

Machinery is depreciated at 20% a year on the balance of the machinery account at the year end. Her draft profit for the year was \$27 590.

(a) Calculate the depreciation that was charged, and the depreciation that should have been charged. **[2]**

(b) Calculate the corrected profit for the year. **[3]**

(c) Calculate the net book value of the machine at 31 December 2026 as recorded and as it should be, and comment on the effect of the errors. [3]

(a) Recorded balance: $8650 + 355 = 9005$; depreciation charged = $20\% \times 9005 = 1801$. **B1**

Correct cost: $8650 + 1140 = 9790$; correct depreciation = $20\% \times 9790 = 1958$. **B1**

(b)

	\$
Draft profit for the year	27 590
Add: installation removed from wages	1 140
Less: insurance is an expense	(355)
Less: extra depreciation (1958 – 1801)	(157)
Corrected profit for the year	28 218

M1 for adding the installation and taking off the insurance, **M1** for the extra depreciation, **A1** \$28 218.

(c) Recorded: $9005 - 1801 = 7204$. Correct: $9790 - 1958 = 7832$. **B1** for both.

The machine's net book value was **understated by \$628**, and so was the profit ($28\,218 - 27\,590 = 628$): the two errors pull in opposite directions, but the capital error is larger. **B1** The statement of financial position did not show the true value of the machine, and profit, and so capital, was understated. **B1**

Common mistakes

- **Calling installation, delivery or legal fees revenue expenditure.** Examiners report these as the usual gap in tick tables. They are part of the cost of getting the asset ready, so they are capital.
- **Calling insurance, fuel or repairs capital** because they are "about" a non-current asset. Examiners note many candidates did this for insurance and petrol. Running and upkeep costs are revenue, however closely linked to the asset.
- **Defining capital expenditure by where the money came from.** Capital expenditure is not "money spent from the owner's capital", and revenue expenditure is not "money spent from sales". Define them by what the money is spent on.
- **Saying only "the profit will be wrong"** when asked why the difference matters. Say which way (over- or understated), and add the effect on non-current assets and what it leads to (drawings, decisions, matching).
- **Forgetting depreciation.** If a repair is capitalised and depreciated, the effect on profit is the amount **less** the depreciation. For a \$530 repair at 10%, saying \$530 instead of \$477 is the classic slip. The opposite slip is taking depreciation off when the question says to ignore it, or when no depreciation is charged in the year of purchase.
- **Mixing up the directions when there are several errors.** Write + or – beside each error before adding them. A capital item treated as revenue *understates* profit, so the correction is **added**.

- **Treating the sale of a non-current asset as a sale in the trading account.** The proceeds are a capital receipt; only the gain or loss on disposal reaches the income statement.
- **Treating a loan or extra capital as income.** Both make profit look bigger. A loan recorded as income also overstates capital and hides a liability. Extra capital recorded as income leaves closing capital unchanged, because the capital introduced is missing from the capital account; it should be credited there directly, never run through profit.
- **Using the purchases account for a non-current asset** in a journal entry. Purchases are goods for resale; debit the asset account and credit the supplier.

How to get the marks

- **"State what is meant by"** needs one clear sentence per term, built on the right idea: *buying, improving or extending non-current assets* (capital expenditure); *day-to-day running* (revenue expenditure); *not from normal trading* (capital receipt); *from normal trading* (revenue receipt).
- **Tick tables** earn one mark per correct row. One tick per row; two ticks in a row score nothing.
- **"Calculate"** the effect: show each figure you add or take off, and label it. Method marks are given for a correct method with the wrong starting figure (marked "OF", own figure, in mark schemes).
- **Always give the direction** (overstated or understated) as well as the amount. An amount alone is not an answer.
- **"Comment on" / "Explain"** needs developed points: the effect (profit or assets over- or understated) **and** why that matters (drawings, decisions, tax, lenders, prudence, matching).
- **Journal entries** need the debit first, the credit below, both amounts, and a narrative when the question asks for one.
- **Multiple choice:** work the answer out before looking at the options. Most wrong options are the answer with the depreciation left out, or with the direction reversed.

Quick check

1. A dentist makes these payments. State whether each is capital or revenue expenditure: (i) a new X-ray machine; (ii) lead lining fitted to the walls of the X-ray room before the machine is first used; (iii) boxes of disposable gloves; (iv) repairing the air conditioning in the waiting room; (v) a computer for keeping patient records.
2. During the year a shop recorded: credit sales of \$4 370, a loan of \$3 500 from a finance company, cash sales of \$1 290, \$2 180 from selling an old display cabinet and \$615 interest on the business savings account. Calculate the total revenue receipts.
3. Tariq's draft profit was \$19 820. A new laptop for the office, \$1 260, had been debited to office expenses. Office equipment is depreciated at 25% a year on the year-end balance, with a full year charged in the year of purchase. Calculate the corrected profit for the year.

4. The owner paid \$7 500 of extra capital into the business bank account, but it was credited to the commission received account. State the effect on gross profit, on profit for the year and on the owner's capital at the year end.

Answers

1. Capital: (i), (ii) and (v), since (ii) is part of getting the machine ready to use. Revenue: (iii), used up in the year, and (iv), upkeep of the existing building.
2. Revenue receipts are the credit and cash sales and the interest: $4370 + 1290 + 615 = 6275$, so \$6 275. The loan and the cabinet (\$5 680) are capital receipts.
3. Office expenses were \$1 260 too high; depreciation of $25\% \times 1260 = 315$ was not charged. Profit was understated by $1260 - 315 = 945$, so the corrected profit is $19\,820 + 945 = 20\,765$, that is \$20 765.
4. Gross profit: **no effect** (commission received is added after gross profit). Profit for the year: **overstated** by \$7 500. Closing capital: **no overall effect**, because capital introduced is \$7 500 too low and the profit added to capital is \$7 500 too high, which cancel out. The capital account is still wrong in detail, and the profit figure misleads the owner.

Past questions to try

- **0452/21/M/J/24 Q4**: part (c) classifies the costs of a new storage area.
- **0452/12/F/M/24 Q15**: the overall effect of three misclassified items on profit.
- **0452/13/O/N/24 Q16**: a service contract debited to machinery, with depreciation.
- **0452/23/O/N/22 Q1**: an income statement with new fittings hidden in repairs, then part (d) on why the difference matters.