

Chapter 6

Capital and Revenue Transactions

NCEA Level 2 accounting material covered in this chapter includes Accounting Achievement Standard 90220 (Accounting 2.1) 'Describe the conceptual basis of accounting for a sole proprietor', by describing:

- Capital and revenue transactions.

Transactions

The financial elements of a business – assets, liabilities, equity, income and expenses – are always changing as the business operates (ie 'as it does business' on a day-by-day basis).

Every working day the financial elements of a business change because of **transactions**. Transactions are events that change the financial elements of the business. The most basic types of transaction involve selling something or buying something. In a shop, the most common transaction would be selling inventory; imagine how many transactions occur daily at *The Warehouse*.

Example A

The changing financial elements

A business buys a new delivery van for cash \$20 000. This would cause the assets of the business to change – the bank account would decrease by \$20 000, and the business would now have an asset called 'delivery van' for \$20 000.

Transactions alter the accounting equation

Every time there is a transaction in a business, the financial elements change. Taking into account the financial elements, the accounting equation can be arranged to form the expanded accounting equation:

Assets (A) + Expenses (Ex) = Liabilities (L) + Equity (E) + Income (I)

Example B

Transactions altering the accounting equation

A business called *Balclutha Bakery* has a number of business transactions:

- Sold bread to a customer for cash \$3.50.
This would increase assets, because there is now an extra \$3.50 in the bank account. The \$3.50 would be record as 'sales', so income would also increase.
- Purchased flour for baking on credit \$250.
Expenses would increase by \$250, because the flour would be classified as a business expense.
Liabilities would increase by \$250, as the supplier is now owed that money for the flour.
- Paid wages \$180.
This would decrease assets, ie bank would decrease by \$180.
Wages expense would increase by \$180.

Double entry

Every time there is a transaction, at least two accounts from somewhere in the expanded accounting equation are affected. This is called **double-entry accounting**.

Activity 6A: Transactions altering the accounting equation

B Rush owns a paint shop called *Pot o' Paints*.

A number of transactions took place during the month of March. Copy the table and show how each transaction would affect the accounting equation. The first transaction has been done as an example – the 'x' indicates what has happened to each of the financial elements as a result of the transaction. (N/C means 'no change'.)

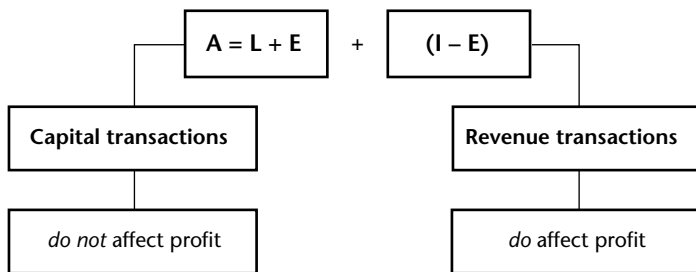
Transaction	Assets			Expenses			Liabilities			Equity			Income		
	Inc	Dec	N/C	Inc	Dec	N/C	Inc	Dec	N/C	Inc	Dec	N/C	Inc	Dec	N/C
Bought paint on credit			x	x			x					x			x
1. Sent invoice to customer for paint															
2. Paid registration on van															
3. Received payment from customer for outstanding amount owed															
4. Paid for ladder bought last month															
5. Sold old ladder for cash															
6. Paid for holiday from business bank account															
7. Received bill for 'Yellow page' advertising															
8. Paid commission to sales staff															
9. Sold paint to customer for cash															

Capital and Revenue Transactions

Transactions that affect the accounting equation can be divided into either capital or revenue transactions.

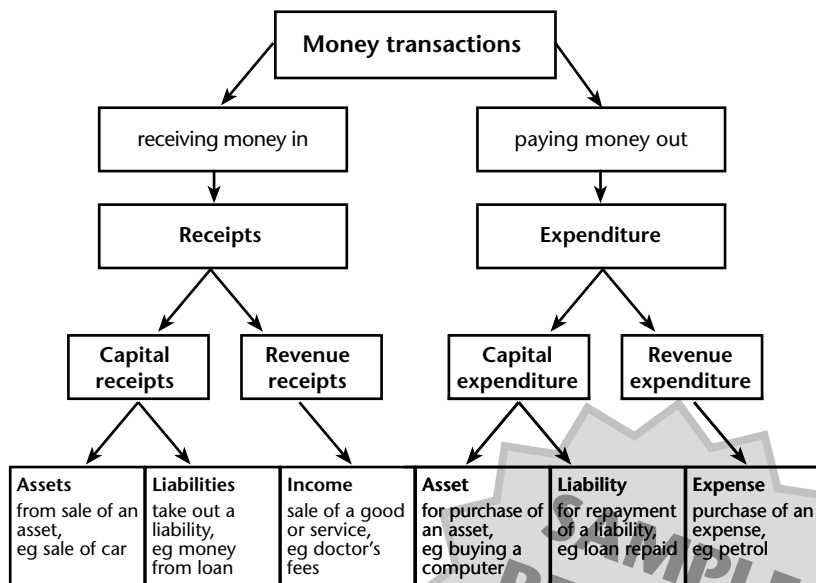
Business transactions can be placed into one of two categories:

- If transactions only affect assets, liabilities and equity, they are called **capital transactions** (eg buying a delivery vehicle is a capital transaction).
- If transactions affect the profit of the business (ie income or expenditure), they are called **revenue transactions**.



Money does only two things – goes out (expenditure) or comes in (receipts).

Money transactions can also be applied in the manner outlined below.



Receipts

Money can come from two sources – capital receipts and revenue receipts.

Capital Receipts

Sale of an Asset

The sale of an asset, such as a car, is a one-off receipt for a business. A car is initially purchased to benefit the business over *several accounting periods*. The business did not purchase the car with the intention of making profit out of its resale. For this reason, the sale of an asset does not affect profit, so the transaction is *only* recorded in the Balance Sheet. (Any *profit* or *loss* on the sale of the asset, will however, go into the Income Statement.)

Asset – Vehicle will decrease.

Asset – Bank will increase.

Chapter 6 Capital and Revenue Transactions

Activity 6A

	Assets			Expenses			Liabilities			Equity			Revenue		
	Inc	Dec	N/C	Inc	Dec	N/C	Inc	Dec	N/C	Inc	Dec	N/C	Inc	Dec	N/C
1.	X					X			X				X	X	
2.		X		X					X				X		X
3.			X			X			X				X		X
4.		X				X		X					X		X
5.			X			X			X				X		X
6.		X				X			X	X					X
7.			X	X			X						X		X
8.		X		X					X				X		X
9.	X					X			X				X	X	

For **3.** and **5.**, instead of an 'X' in Asset N/C, could have an 'X' in Asset Inc and an 'X' in Asset Dec.

(A – all correct)

Glossary/Index

account (151): see *ledger account*.

accountants (2): qualified people who prepare financial information for their clients or employers.

accounting (1): an information process that provides financial data to people or groups who may have an interest in the affairs of a business; the financial information is used to aid business decisions.

accounting cycle (3): the accounting process is a continual one, repeated annually, from source documents through to the financial statements.

accounting entity (7): financial affairs of owner should be kept separate from financial affairs of business.

accounting equation (11): basis for accounting; shows the relationship between assets, liabilities and equity as $A = L + E$, which is then expanded to show the effect of expenses and income as $A = L + E + (I - Ex)$ or $A + Ex = L + I + E$.

accounting process (3): the system that takes information from source documents through to the financial statements.

accounts payable (65): individuals or businesses that are owed money by a business; also called *creditors*.

accounts payable ledger control account (195): account kept in the General Ledger, the balance of which reflects the total amount owed by all creditors in the Accounts Payable Ledger.

accounts receivable (81): individuals or businesses that owe money to the business. Also called *debtors*.

accounts receivable collection period (302): see *age of debtors*.

accounts receivable ledger control account (195): accounts kept in the General Ledger, the balance of which reflects the total amount owed by all debtors in the Accounts Receivable Ledger.

accrual accounting (260): accounting information is recorded when the transaction occurs but reported in the period that it relates to.

accrual basis (36): accounting information is recorded in the accounting period it occurs in and reported in the accounting period to which it refers (eg an insurance prepaid for next year is recorded when it is paid but won't be reported as an expense until the next year).

accumulated depreciation (30): the total amount of depreciation that has accumulated for a particular asset; deducted from the asset in the financial statements.

acid test (295): see *liquid ratio*.

actual cost (101): see *identifiable cost*.

administration expenses (38): expenses related to management or overheads.

age of debtors (302): shows the efficiency of a business's credit policy, by finding the average time taken by debtors to pay their accounts.

aged debtors (84): schedule listing debtors and showing the age (in months) that debts have been outstanding.

allowance for doubtful debts (30): a reduction in the asset debtors; the amount anticipated that will not be collected from debtors appearing in the Balance Sheet.

analysis (291): information used to interpret financial statements and give extra information to the users of accounting information; requires the use of ratios and percentages.

analysis columns (137): columns used to list any expenses or income in the cash journals.

assets (11): service potential or future economic benefits controlled by the entity as a result of past transactions or other past events.

auditors (2): accountants who examine the financial records of a company to give an opinion on the financial arrangements.

automatic payment (126): amounts deducted from a bank account automatically by prior arrangement with the bank.

bad debt (209): amount owed to a business which is uncollectable and needs to be/has been written off.

balance (3): one figure totalling all the figures above it or representing all the debits or credits in an account.

balance day adjustments (259): journal entries posted to the ledger on the last day of the financial year; prepared to recognise assets and liabilities at balance date.

Balance Sheet (21): financial statement showing the financial position of a business at a certain point in time; prepared at least once a year; contains assets, liabilities and equity.

bank reconciliation (213): the process of comparing the bank's records with the business's records.