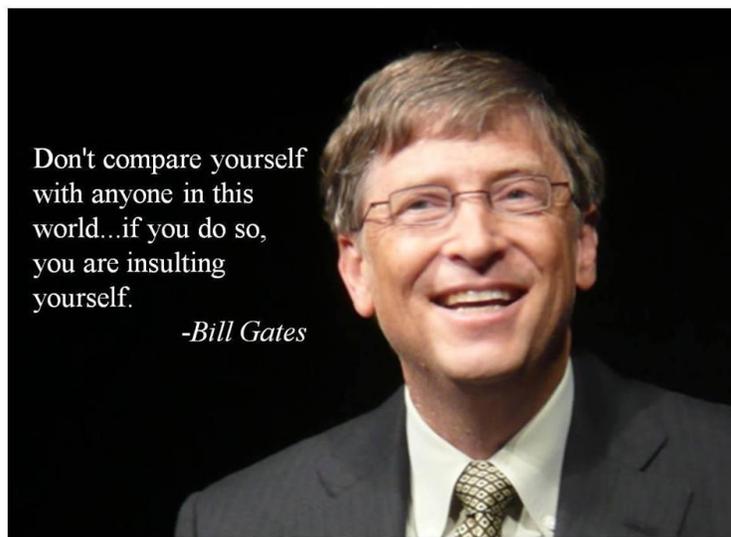


THEORETICAL FRAMEWORK

SOLUTION TO Q.16.

1. **False:** Overhaul expenses are incurred to put second-hand machinery in working condition. So it should be capitalised.
2. **False:** It may be reasonably presumed that money spent for reducing revenue expenditure would have generated long-term benefits to the entity. So this is capital expenditure.
3. **True:** Legal fee paid to acquire any property is part of the cost of that property. It is incurred to possess the ownership right of the property and hence a capital expenditure.
4. **False:** Legal expenses incurred to defend a suit claiming that the firm's factory site belongs to the plaintiff are maintenance expenditure of the asset. Maintenance expenditure in relation to an asset is revenue expenditure.
5. **False:** Amount spent for replacement of any worn out part of a machine is revenue expense since it is part of its maintenance cost.
6. **False:** Repairing and white washing expenses for the first time of an old building are incurred to put the building in usable / working condition. These are the part of the cost of building. Accordingly, these are capital expenditure.
7. **True:** The Cinema Hall could not be started without license. Expenditure incurred to obtain the license is pre-operative expense (incurred before the working condition) which is capitalised.
8. **True:** Cost of temporary huts constructed which were necessary for the construction of the cinema house is part of the construction cost of the cinema house. Therefore such costs are to be capitalised.



SOLUTION TO Q.17.

1. Money paid Rs. 10,000 for obtaining license to start a factory is a capital expenditure.
2. Rs. 1,000 paid for removal of Inventory to a new site is revenue expenditure. Such expenditure occur regularly during business.
3. Rs. 5,000 spent in changing Rings and Pistons of an engine to get fuel efficiency is capital expenditure. This is an expenditure on improvement of a fixed asset resulting in increase in its efficiency.
4. Money deposited with MTNL for installation of telephone in office is not an expenditure. This is treated as an asset and the same is adjusted over a period of time against actual telephone bills.
5. Cost of construction of building including cost of temporary huts is capital expenditure. Building is fixed asset which will generate enduring benefit to the business over more than one accounting period. Construction of temporary huts is incidental to the main construction. Such cost is also capitalised with the cost of building.

SOLUTION TO Q.18.

- i. The total cost of the furniture should be treated as Rs. 10,200 i.e., all the amounts mentioned should be capitalised since without such expenditure the furniture would not be available for use.
- ii. License for running the cinema house is necessary, hence its cost of Rs.20,000 should be capitalised. But the fine of Rs.1,000 is revenue expenditure. The renewal fee of Rs.2,000 for the next year is also revenue expenditure but pertains to the next year; hence, it is a prepaid expense.
- iii. Half of the insurance premium pertains to the year beginning on 1st April, 2016. Hence such amount should be treated as prepaid expense. The remaining amount is revenue expense for the current year.
- iv. Since the temporary huts were necessary for the construction, their cost should be added to the cost of the cinema hall and thus capitalised.



SOLUTION TO Q.19.

1. Overhauling expenses are incurred for the engine of a motor car to derive better fuel efficiency. So this expenditure should be capitalised.
2. Inauguration expenses incurred on the opening of a new unit is in the nature of revenue expenditure, as this expenditure is not necessary to bring assets into working condition.
3. The amount paid to workers on voluntary retirement is in the nature of revenue expenditure. But since the magnitude of the amount of expenditure is very high, it is better to capitalize it.

SOLUTION TO Q.20.

- i. Capital expenditure since without such expenditure the capital assets would not be available for use.
- ii. Revenue receipt as this receipt is a normal regular receipt of business.
- iii. Capital expenditure since the demolition of old building was necessary for the construction of big building, their cost should be added to the cost of the building.
- iv. Capital receipt as this receipt occur once in a while and normally involves huge amount.

SOLUTION TO Q.21.

- i. Renovation of cabins increased the number of cabins. This has an effect on the future revenue generating capability of the business. Thus the renovation expense is capital expenditure in nature.
- ii. Expense incurred to recover installments due from customer does not increase the revenue generating capability in future. It is a normal recurring expense of the business. Thus the legal expenses incurred in this case are revenue expenditure in nature.
- iii. Expenses incurred on account of transportation of fixed asset are capital expenditure in nature.

