

The concepts of revenue and expenditure and their accounting effects

Marita Kristiansen^a and Norvald Monsen^b

^aDepartment of Professional and Intercultural Communication

^bDepartment of Accounting, Auditing and Law

Norwegian School of Economics and Business Administration (NHH)

Summary

The aim of this contribution is to problematise the way the concepts of revenue and expenditure are used in the domain of accounting without taking into account their different accounting effects depending on whether the accounts are prepared to be used in for instance a limited company, a non-profit organisation, or a municipality, respectively. We suggest an expanded conceptual apparatus to be used than what is the case in present Anglo-Saxon accounting models which better reflects these effects of revenues and expenditures.

A personal note

Åge has for many years developed Norwegian terminology within domains which are to an ever-increasing extent influenced by English. His knowledge of specialised communication, not only within a specific domain and specific language, but also when crossing cultural borders, is impressive. We have been fortunate to have Åge as both our lecturer and colleague and have through this learned that using expressions such as 'being sent to Coventry' or to make use of 'Chapter 11' requires not only knowledge of Norwegian and English, but also of the particularities of the various cultures of the countries and domains involved. Also, Åge's translations of financial reporting documents have not only rescued local public administrators meeting with their US colleagues, but are still useful to us in both teaching and research.

1 Introduction

Reliable accounts are essential for any kind of organisation, whether it is a public limited company, a non-profit organisation, or a municipality. It is important to record revenues and expenditures to keep track of the organisation's financial development and situation at any given time. This means that the accounts must communicate information which is understood the same way by the organisation's stakeholders.

If those communicating with each other do not have a common understanding of the knowledge units that are at the centre of the discussion, misunderstandings can easily arise. In particular, if several expressions, or terms, are used to describe the same knowledge units, or concepts, stakeholders may perceive the financial situation of the organisation differently. Also, if a term is used to describe what are in fact two different concepts, confusion is easily the result. The picture becomes even more complicated if we cross language borders, something which is frequently the case for Norwegian organisations which have stakeholders that require a parallel language presentation of the accounts, e.g. in Norwegian and English.

In the following we will take a closer look at the two main concepts in accounting, i.e. REVENUE and EXPENDITURE.¹ Most of us have a general understanding of these two concepts; however, in a proper accounting situation, different dimensions of the two concepts are relevant depending on the organisation for which the accounts are prepared. In particular, revenues and expenditures will have different accounting effects depending on the purpose of the organisation in question. Hence, we will investigate and illustrate how existing accounting models used in teaching or for the preparation of actual accounts could be expanded to better take into account the different accounting effects of prospective revenues and expenditures, i.e. possible money and profit effects, respectively. As will be evident from our discussion, we will propose an expanded conceptual apparatus where some of the subordinate concepts will only be relevant for public-sector and non-profit making organisations, i.e. *current due revenue* and *current due expenditure*.

In our discussion, a Continental accounting tradition, in particular the German, will be taken as a point of departure. Whereas the European initiative to harmonise the presentation of financial statements of public limited companies, through the international accounting standards (IAS) and the international financial reporting standards (IFRS) adopted by the EU in 2002, is characterised by an Anglo-Saxon accounting tradition, we believe that the German tradition offers an approach to the understanding of the two concepts of REVENUE and EXPENDITURE not taken into account in the Anglo-Saxon one. Furthermore, we also believe that the Continental approach provides us with concepts which better take into account the different accounting effects of revenues and expenditures relevant for non-profit and public-sector organisations such as municipalities.

2 The two main accounting concepts – REVENUE and EXPENDITURE

According to Mülhaupt (1987; German text), the main accounting concepts are EINNAHMEN [revenues; inntekter] and AUSGABEN [expenditures; utgifter]. In his book from 1987, he discusses the two concepts and presents their subordinate concepts as shown in Figure 1.

Based on Figure 1, we will in the following discuss an extension of what may be described as the concept fields of *revenue* and *expenditure*. We will present an English-language version below in which we have developed further the concept fields by taking on another perspective resulting in the addition of new subordinate concepts (see Figures 2 and 3; for a Norwegian-language version of these, see Figures A1 and A2 in the Appendix).

¹ To distinguish between concepts, terms and equivalents in the discussion, concepts are capitalised, i.e., REVENUE, whereas their designations, terms, are indicated by single quotes, i.e., 'revenue' and their translations are given in brackets i.e., [inntekt], respectively.

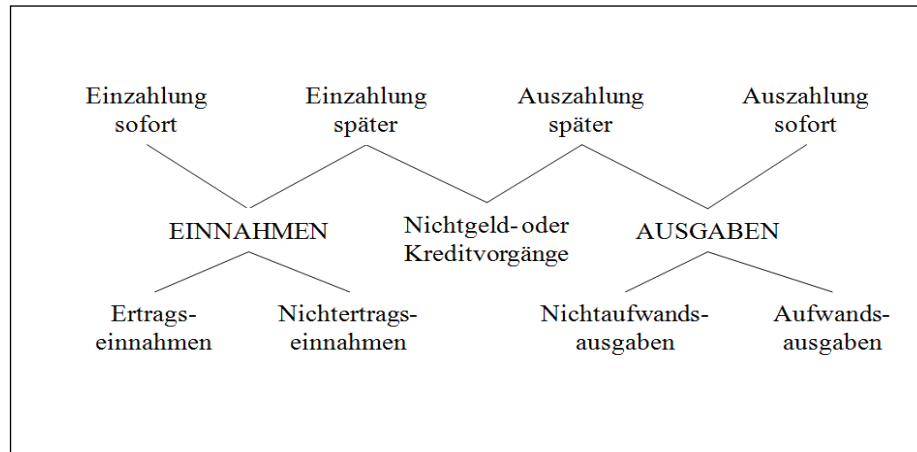


Figure 1: The concepts of EINNAHMEN and AUSGABEN

(Source: Mülhaupt 1987, Abbildung 5, p. 75)

The concept of EINNAHMEN [revenues; inntekter] may be defined as claims on cash receipts. These claims on cash receipts may be subdivided into two concepts depending on whether the cash transactions take place immediately or later, resulting in EINZAHLUNG SOFORT [immediate cash receipts; umiddelbare kontantinntekter] or EINZAHLUNG SPÄTER [later cash receipts; senere kontant inntekter], respectively. The second concept of AUSGABEN [expenditures; utgifter] may be defined as obligations for cash payments, either immediately or later. Again, a subordination of concepts will result in AUSZAHLUNG SOFORT [immediate cash payments; umiddelbare kontantutgifter] and AUSZAHLUNG SPÄTER [later cash payments; senere kontantutgifter], respectively. In order to clearly point out that later cash transactions do not have immediate cash effects, Mülhaupt (ibid.) uses the term ‘Nichtgeld- oder Kreditvorgänge’ [non-money or credit transactions; ikke-pengetransaksjoner eller kreditt-transaksjoner]. The *cash effects* of the revenues and expenditures are described in the upper part of Figure 1.

Revenues and expenditures could, however, also have *profit effects* in addition to the cash effects, resulting in the concepts of ERTRAGSEINNAHMEN [profit revenues; lønnsomhetsinntekter] and AUFWANDSAUSGABEN [expense expenditures; kostnadsutgifter]. However, if the revenues and expenditures do not have profit effects during the accounting period in question, they are referred to as ‘Nichtertrags-einnahmen’ [non-profit revenues; ikke-lønnsomhetsinntekter] and ‘Nichtaufwandsausgaben’ [non-expense expenditures; ikke-kostnadsutgifter], respectively (see the lower part of Figure 1).

As distinct from the cash effects of the revenues and expenditures, which influence the cash deposits of an organisation, the profit effects of the revenues and expenditures influence the equity of the organisation, i.e. as cash deposits plus other assets minus liabilities.

3 An expanded conceptual approach

So far we have discussed the concepts of REVENUE and EXPENDITURE at the same level of detail as Mülhaupt (1987; see Figure 1). Taking his model as a point of departure, we will discuss these concepts in more detail, in order to suggest an expanded conceptual apparatus

and a perhaps better terminology to use when discussing the various accounting effects of revenues and expenditures. This is conveyed in Figures 2 and 3 below, where we turn to English in our description.

As pointed out above, the upper part of Figure 1 reports the relations between REVENUE and EXPENDITURE and their cash effects taking on a time perspective (in the form of IMMEDIATE CASH RECEIPT or LATER CASH RECEIPT and IMMEDIATE CASH PAYMENT or LATER CASH PAYMENT, respectively).

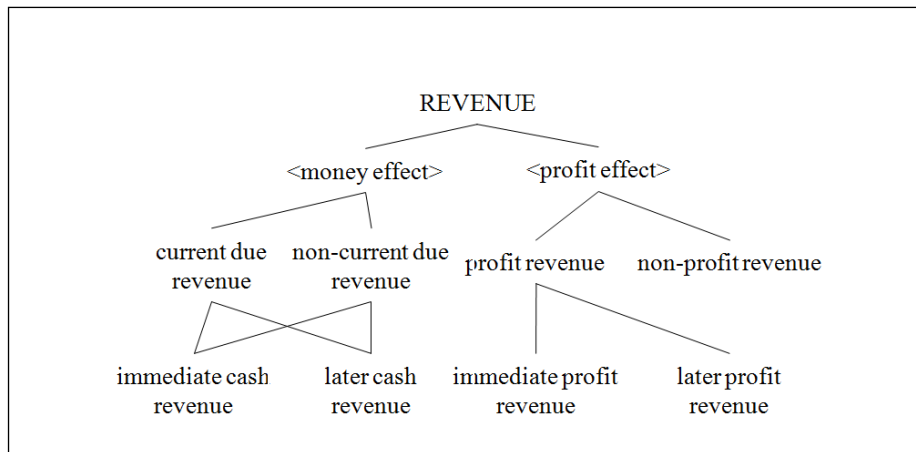


Figure 2: The concept of REVENUE - an expanded approach

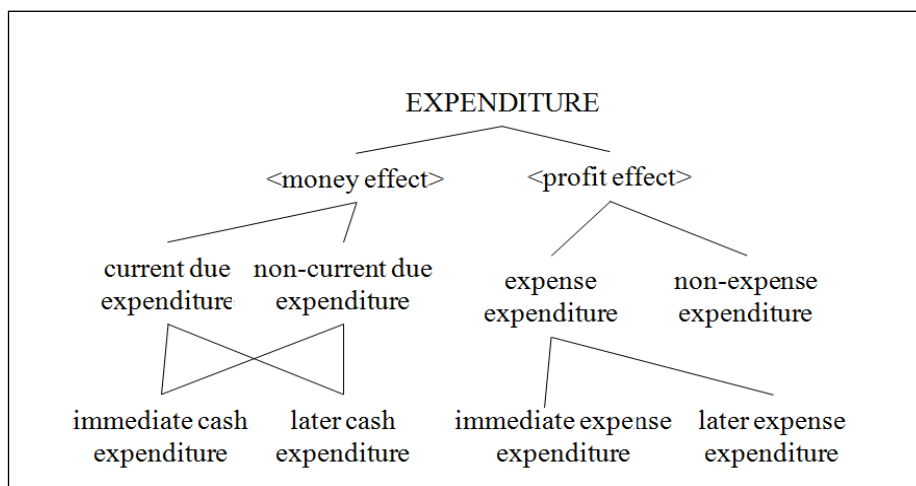


Figure 3: The concept of EXPENDITURE – an expanded approach

In the following, however, we will introduce the concept of MONEY, incorporating both these cash effect concepts because this is of relevance from an accounting point of view. To explain this extension of concepts we should take a closer look at accounting as such. When preparing the accounts for a specific period, the revenues and expenditures of an organisation may be accrued with a view to their respective *money effects* or with a view to their

respective *profit effects*. We therefore face two different accrual principles, a *money accrual principle* and a *profit accrual principle*.

3.1 *The money accrual principle of accounting*

In Figures 2 and 3, the concepts of REVENUE [inntekt] and EXPENDITURE [utgift] refer to revenue incurred [påløpt inntekt] and expenditure incurred [påløpt utgift], respectively. Those parts of the revenues and expenditures that have been instructed for cash receipt and cash payment are referred to as ‘current due revenue’ [anordnet inntekt] and ‘current due expenditure’ [anordnet utgift], respectively. The term ‘current due’ is in fact an English translation of the German concept SOLL, presented by the German professor Karl Oettle, when referring to revenues and expenditures which have been instructed for cash receipt and cash payment, respectively, and thus representing current due amounts (see Oettle 1990).

The remaining parts of the revenues and expenditure that have not been instructed for cash receipt and cash payment are referred to as ‘non-current due revenue’ [ikke-anordnet inntekt] and ‘non-current due expenditure’ [ikke-anordnet utgift], respectively. The concepts of IMMEDIATE CASH REVENUE [umiddelbar kontantinntekt] and IMMEDIATE CASH EXPENDITURE [umiddelbar kontantutgift], refer to those parts of the revenues and expenditures which have been received in cash and paid cash, respectively, during the accounting period in question. The concepts of LATER CASH REVENUE [senere kontantinntekt] and LATER CASH EXPENDITURE [senere kontantutgift] refer to those parts of the revenues and expenditures, which are to be received in cash and paid cash, respectively, in later accounting periods.

In the public sector, at least in continental European countries as well as in Norway, there is a basic principle saying that instructions for cash receipts and cash payments are to be issued by an actor with payment instruction authority, such as the chief municipal administrative officer. Then cash may be received and cash may be paid, respectively, by another actor with cash receipt and payment execution authority, such as the municipal cashier. This is, however, not a principle in the private sector, where cash is exchanged for goods and services without first issuing cash receipt or cash payment instructions. In any case, revenues may be received in cash (referred to as ‘immediate cash revenue’ in Figure 2) whereas expenditures may be paid (referred to as ‘immediate cash expenditure’ in Figure 3), independent of whether instructions for cash receipts and cash payments have been/will be issued or not. This also appears from Figures 2 and 3 (and from Figures A1 and A2 in Norwegian).

The explanation above implies that we face three different alternatives for how to accrue the revenues and expenditures with regard to their respective money effects. That is, the revenues and expenditures may be accrued with a view to whether they have been incurred, have been instructed for cash receipt and cash payment, respectively, or have been received in cash and paid cash, respectively. These three alternatives are reflected in the three concepts of the INCURRED PRINCIPLE [påløptprinsippet], the CURRENT DUE PRINCIPLE [anordningsprinsippet], and finally, the CASH PRINCIPLE [kontantprinsippet]. This is illustrated by the subordination criterion *money effect* to the left-hand side of Figures 2 and 3 (see Figures A1 and A2 for a Norwegian language version).

3.2 The profit accrual principle of accounting

As distinct from the left-hand side of Figures 2 and 3, which focuses on the money effects of the revenues and expenditures, the right-hand side of the figures focuses on their profit effects, if this is relevant for the organisation in question. It is for instance of interest to market-linked business enterprises, but not to governmental budget-linked core administrations (see discussion below).

Given such an interest, we may first split the revenues and expenditures into two groups: revenues and expenditures having profit effects and revenues and expenditures not having profit effects. Revenues with positive profit effects are referred to as ‘profit revenue’ [lønnsomhetsinntekt], while expenditures with negative profit effects are referred to as ‘expense expenditure’ [kostnadsutgift]. Revenues and expenditures without profit effects are referred to as ‘non-profit revenue’ [ikke-lønnsomhetsinntekt] and ‘non-expense expenditure’ [ikke-kostnadsutgift], respectively. Examples here may be external loan revenues and instalment expenditures.

The profit revenues and expense expenditures may in turn be categorised as follows: The part of the revenues which has positive profit effects during the accounting period in question is referred to as ‘immediate profit revenue’ [umiddelbar lønnsomhetsinntekt], while the part of the expenditures which has negative profit effects during this period is referred to as ‘immediate expense expenditure’ [umiddelbar kostnadsutgift]. Examples here may be revenues from sale of pens and expenditures for raw materials which have been used during the accounting period in question for producing the pens, respectively. Revenues and expenditures with profit effects in later periods are referred to as ‘later profit revenue’ [senere lønnsomhetsinntekt] and ‘later expense expenditure’ [senere kostnadsutgift], respectively. Examples here may be revenues in the form of prepayment from customers, which will have positive profit effects in later accounting periods and investment expenditures, which will have negative profit effects (in the form of depreciation) in later accounting periods.

4 Discussion

All organisations incur expenditures which must be financed by revenues in order for the organisation to survive. Different types of organisations acquire, however, financial resources in the form of revenues in different ways. Based on this principle we may distinguish between market-linked and budget-linked organisations (Danielsson 1977). Market-linked organisations acquire financial resources through market exchange transactions, where goods and services are exchanged for money. Business enterprises are examples of such organisations. Governmental core administrations, such as a city treasury may, however, be referred to as budget-linked organisations, because they primarily acquire revenues through one-way money transactions, as opposed to market exchange transactions. This means that they receive tax revenues from the inhabitants, without giving a direct service in return. The expenditures from service delivery to the inhabitants occur in various parts of the core governmental administration, like the school department, the health department, etc., while the tax revenues are received by the treasury department. Therefore, the budget is used for allocating tax revenues to the various departments in order for them to finance their expenditures, hence, the term ‘budget-linked organisations’.

Since private market-linked enterprises and the budget-linked core governmental administration (referred to as the ‘governmental sector’) acquire revenues in different ways,

i.e. through market exchange transactions and one-way money transactions, respectively, historically there have been differences between the accounts prepared in the business and governmental sectors. In the former sector, accounts have been prepared, reporting the profit effects of the revenues and expenditures whereas in the latter sector accounts have been prepared, reporting the money effects of the revenues and expenditures. In recent years, however, and resulting from transferring business management ideas to the governmental sector, referred to as *New Public Management* (NPM), traditional governmental accounts are in the process of being replaced by profit accounts, influenced by profit accounts prepared in the business sector (see e.g. Monsen 2010).

If we take a closer look at the business accounting literature as well as the international business accounting standards, we will see that the accounting terminology used is somewhat unfortunate. First, the imprecise term ‘accrual accounting’ is generally used when referring to business accounting. As we have pointed out above, however, we face two different accrual accounting principles, a money accrual principle and a profit accrual principle.

Second, the concept of REVENUE is generally used when referring to the profit effect of the revenues (i.e. PROFIT REVENUE in Figure 2). When we only focus on business accounting, and if everybody seems to have the understanding that ‘accrual accounting’ means ‘profit accrual accounting’ and that REVENUE means PROFIT REVENUE, this might perhaps be acceptable. However, if we also refer to accounting for governmental and non-profit organisations, where the concept of REVENUE refers to the money effect of the revenues (referred to as REVENUE in Figure 2), thus requiring the use of a ‘money accrual principle’, we might have some problems of miscommunication. If we take on a business sector perspective, REVENUE refers to the *profit effect* of the revenues. However, if we take on a governmental sector perspective, REVENUE refers to the *money effect* of the revenues. Hence, we will argue that it would be advantageous if a more precise and general accounting terminology were developed than what seems to be the case within the business accounting literature today.

If the accounting terminology, in its description of for instance the concepts of REVENUE and EXPENDITURE, becomes more precise, misunderstandings between the business sectors on the one hand and the governmental and non-profit sectors on the other hand might be avoided. Also, a better understanding of which effects of the revenues and expenditures are reported in different accounting models, will be achieved. Specifically, if we apply the concept of PROFIT REVENUE instead of the concept of REVENUE when discussing the *profit effect* of the revenue, it will be easier to understand that it is actually the *profit effect* which is reported in so-called ‘accrual accounting’. Thus a better motivated term would in fact be ‘profit accrual accounting’.

A timely question is then whether an accounting model reporting the profit effects of the revenues and expenditures, such as the so-called ‘accrual accounting model’, developed for marked-linked business enterprises, is appropriate to use for governmental budget-linked organisations. The current international development actually shows that so-called ‘accrual accounting’, in the form of ‘profit accrual accounting’, is being introduced in the governmental budget-linked organisations in an increasing number of countries, even though we find different accounting contexts in different types of organisations. In our opinion, one reason for this development is that many actors are not aware of the fact that the so-called ‘accrual accounting’ model reports the profit effect of the revenues, because they are used to apply the concept of REVENUE instead of PROFIT REVENUE.

5 Concluding remarks

To conclude, our discussion shows that different kinds of organisations will need different kinds of information about their revenues and expenditures, i.e. information about their money effects or their profit effects. It is therefore of utmost importance to have a good understanding of the concept fields of revenues and expenditures, including their subordinate concepts. In order to acquire such an understanding, Figures 2 and 3, and also Figures A1 and A2 in Norwegian, may provide useful insight.

In particular, by defining the concepts of REVENUE and EXPENDITURE more clearly than what seems to be the case in current Anglo-Saxon accounting literature, especially the business accounting literature, we may acquire a better understanding of what kind of information a particular accounting model contains. As we have shown in our discussion, Continental and in particular German accounting theory may provide a useful point of departure in this connection. Second, we may avoid possible misunderstandings between actors from different sectors who believe they are discussing the same matter when they in fact are discussing related, but not identical concepts. Third, we will be able to make a better judgment of whether or not one particular accounting model, developed for use in a particular context, like the business context, would be appropriate to use also in other contexts, such as a governmental context.

References

- Danielsson, Albert (1977) *Företagsekonomi – en översikt*. Lund: Studentlitteratur.
- Monsen, Norvald (2010) Public Sector Accounting: Democratic Control of Public Money by Using Administrative Cameralistics. *International Journal of Governmental Financial Management* 10 (1). 20-34.
- Mülhaupt, Ludwig (1987) *Theorie und Praxis des öffentlichen Rechnungswesens in der Bundesrepublik Deutschland*. Baden-Baden: Nomos.
- Oettle, Karl (1990) Cameralistics. In: Grochla, Erwin/Gaugler, Eduard/Büschgen, Hans E. (eds) *Handbook of German Business Management*. Stuttgart: Poeschel.