CAPITALIZE or EXPENSE

MICRO BUSINESS ACADEMY™
MINDSET-BELIEVE-ACHIEVE

CAPITALIZING

Recognizing an expense on the balance sheet as an asset, and then regularly reducing its value over time by a depreciation expense in the income statement.

EXPENSING

Recognizing an expense in the income statement in the same period it was incurred, rather than spreading it over several periods as in the case of capitalized expenses.

STATEMENTS IMPACTED

Capitalizing

- **Balance Sheet** >> PPE, cash or liabilities
- **Income Statement** >> depreciation expense
- **Cash Flow Statement** >> investing cash flows

Expensing

- **Balance Sheet** >> cash or liabilities
- **Income Statement** >> expenses
- **Cash Flow Statement** >> operating cash flows

KEY RATIOS IMPACTED

Capitalizing

- **Return on Assets**
- **Return on Equity**
- **Debt to Equity Ratio**
- **Earnings per Share**
- **Asset Turnover Ratio**

Expensing

- **Return on Assets**
- **Return on Equity**
- **Debt to Equity Ratio**
- **Earnings per Share**

RECOGNITION

- **When:** future economic benefits associated with the item must be probable and the cost of the item must be reliably measured
- **How much:** initially be recorded at cost, which includes all costs necessary to bring the asset to working condition for its intended use

- **Depreciation** begins when the asset is available for use and continues until the asset is derecognised
- **Maintenance CAPEX** is expensed (maintains asset current condition and performace)
- **Improvement CAPEX** is capitalized (increases asset capacity, efficiency, or lifespan)

EXAMPLES

Capitalizing

- **Software development** costs that meet capitalization criteria
- **Storage costs** of whiskey barrels incurred in the process of ageing it
- **Legal fees** developing capitalized patent assets

Expensing

- **Software research costs** to determine feasibility of developing your new software
- **Storage costs** of warehoused whiskey awaiting delivery to your customers
- **Legal fees** to defend against a supplier lawsuit