

Paper 1 – Financial Accounting

Aim

This paper aims at testing students' understanding of the basic accounting principles, and their ability to apply concepts of financial accounting and methods to record business transactions and to prepare and interpret financial statements.

Content

1. The role of financial accounting and reporting

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Understanding of the role of financial accounting and reporting	<ul style="list-style-type: none">• Describe the nature, scope and purposes of financial statements and their related records and accounts	1
	<ul style="list-style-type: none">• Identify and explain the qualitative characteristics of financial statements	2
	<ul style="list-style-type: none">• Identify the users of financial accounts and statements and explain their information needs	2

2. The principles of financial accounting

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Understanding of the principles of financial accounting	<ul style="list-style-type: none">• Explain and apply the following accounting concepts, principles and conventions:<ul style="list-style-type: none">- going concern- accrual- consistency- materiality- prudence- business entity- accounting period- historic cost- money measurement- substance over form	2
	<ul style="list-style-type: none">• Describe the accounting standards and guidelines and their application to external financial reports	2
	<ul style="list-style-type: none">• Explain the need for generally accepted accounting principles (GAAP) and apply them in the practice of accounting	2

3. Recording, handling and summarising accounting data

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Understanding of the books of original entry	<ul style="list-style-type: none"> • Describe the functions of the following books of original entry: <ul style="list-style-type: none"> - cash book - petty cash book - sales journal/book - purchases journal/book - returns inward journal/book - returns outward journal/book - general journal 	1
Understanding of the double entry accounting system	<ul style="list-style-type: none"> • Explain the double entry accounting system • Apply the accounting equation (Assets = Owner's Equity + Liabilities) • Classify and record business transactions in terms of the accounting equation 	2 3 3
Skill in applying the accounting equation and double entry accounting system to business transactions through to preparing a trial balance	<ul style="list-style-type: none"> • Prepare the following books of original entry from source records: <ul style="list-style-type: none"> - cash book - petty cash book (including imprest system) - sales journal/book - purchase journal/book - returns inward journal/book - returns outward journal/book - general journal • Record the posting of journal entries to the following ledger accounts: <ul style="list-style-type: none"> - general ledger accounts - sales ledger accounts - purchases ledger accounts • Extract a trial balance from the ledger accounts 	3 3 3
Skill in keeping control accounts	<ul style="list-style-type: none"> • Describe the functions of control accounts • Prepare the following control accounts: <ul style="list-style-type: none"> - sales ledger control account - purchases ledger control account • Reconcile control accounts with ledger balances 	2 3 3

3. Recording, handling and summarising accounting data (continued)

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Skill in preparing a bank reconciliation statement	• Explain the use of a bank reconciliation statement	2
	• Prepare a bank reconciliation statement	3
Understanding of the correction of errors and the skill in preparing suspense accounts	• Describe various types of errors	2
	• Describe the purpose of a suspense account	2
	• Prepare journal entries to correct errors and post the entries to respective ledger accounts, including the suspense account	3

4. Fixed assets, current assets and pre-closing adjustments

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Understanding of capital and revenue expenditure	• Distinguish between capital and revenue expenditure	3
Knowledge of the accounting treatment of fixed assets	• Define fixed assets	2
	• Explain depreciation and the reasons for and methods of providing for it	3
	• Describe the factors to be considered in formulating the depreciation policy	2
	• Record the accounting treatment for providing depreciation for and disposing of fixed assets	3
Knowledge of the accounting treatment of current assets	• Define and provide examples of current assets	2
	• Define inventories and debtors	2
	• Distinguish between perpetual and periodic inventory systems	2
	• Explain and justify the valuation of inventories at the lower of cost and net realisable value	3
	• Explain bad debts and the provision for doubtful debts and prepare the relevant accounting entries	3

4. Fixed assets, current assets and pre-closing adjustments (continued)

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Skill in handling pre-closing adjustments	<ul style="list-style-type: none"> • Prepare the accounting treatment (journal entries and ledger posting) for pre-closing adjustments including: <ul style="list-style-type: none"> - accruals - prepayments - income in arrears - income in advance 	3

5. Preparing financial statements

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Skill in preparing financial statements for sole traders	<ul style="list-style-type: none"> • Prepare an income statement (trading and profit and loss account) and a balance sheet of a sole trader from a trial balance or incomplete accounting records 	3
Skill in preparing financial statements for clubs and societies	<ul style="list-style-type: none"> • Prepare a receipts and payments account, an income and expenditure account and the corresponding balance sheet for a club and society 	3
Skill in preparing financial statements for partnerships	<ul style="list-style-type: none"> • Prepare an income statement and an appropriation account and a balance sheet for a partnership, incorporating: <ul style="list-style-type: none"> - pre-closing adjustments - interest on capital - partners' salary - interest on drawings - share of profits and losses 	3
	<ul style="list-style-type: none"> • Distinguish between partners' capital and current accounts 	2
	<ul style="list-style-type: none"> • Prepare capital and current accounts for partners 	3
	<ul style="list-style-type: none"> • Record admission and retirement of partners and prepare the balance sheet for the new partnership 	3
	<ul style="list-style-type: none"> • Describe the nature of goodwill and explain its accounting treatment 	3
	<ul style="list-style-type: none"> • Explain and record the revaluation of assets 	3
	<ul style="list-style-type: none"> • Record the dissolution of partnership 	3

5. Preparing financial statements (continued)

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Skill in preparing financial statements for limited companies	<ul style="list-style-type: none"> • Explain the nature and purposes of share capital, reserves and debentures 	2
	<ul style="list-style-type: none"> • Record the issue of shares 	3
	<ul style="list-style-type: none"> • Prepare an income statement and appropriation account as well as a balance sheet for a limited company 	3
Skill in preparing financial statements for manufacturing companies	<ul style="list-style-type: none"> • Prepare a manufacturing account and an income statement for a manufacturing company showing the following: <ul style="list-style-type: none"> - prime cost - factory costs of goods produced - transfer price of finished goods produced 	3
	<ul style="list-style-type: none"> • Prepare a balance sheet for a manufacturing company 	3
	<ul style="list-style-type: none"> • Explain the use of transfer prices for goods transferred from the factory to the warehouse 	3

6. Interpretation of financial statements

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
Skill in analysing financial statements, including calculation of significant ratios and appraisal of the performance and future prospects of a business	<ul style="list-style-type: none"> • Calculate the following accounting ratios: <ul style="list-style-type: none"> - gross profit margin - net profit margin - return on capital employed - asset turnover ratio - current ratio - quick (acid test) ratio - inventory turnover ratio - debtors' collection period - creditors' repayment period - gearing ratio - interest cover ratio - dividend cover - dividend yield - earnings per share - price earnings ratio 	2

6. Interpretation of financial statements (continued)

Competence Required	Activity to Develop and Demonstrate Competence	Indicative Level
	<ul style="list-style-type: none"> • Explain the significance of and reasons for changes in ratios over time or differences in ratios between two companies in terms of: <ul style="list-style-type: none"> - profitability and use of assets - short term liquidity - long term solvency - investment ratio 	3

Examination format:

Section A	10 – 25 multiple choice questions	25 marks
Section B	3 out of 4 questions	75 marks

		100 marks
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Essential reading:

<u>Author</u>	<u>Title</u>	<u>Publisher</u>
Li, A. T. M. and Ng, P. P. H.	Financial Accounting (2005 Edition)	HKIAAT (formerly HKAAT)

Additional reading:

<u>Author</u>	<u>Title</u>	<u>Publisher</u>
Wood, F., Sangster, A., Yau, L., Yau, R. and Yau, J.	Frank Wood's Business Accounting – Hong Kong (Volumes 1 and 2) (3 rd Edition)	Longman
Millichamp, A. H.	Foundation Accounting (5 th Edition)	<u>Continuum</u> <u>Letts</u> <u>Educational</u>