ACCA

F3
FINANCIAL ACCOUNTING (International)

Study System – Volume 1
Sample Session
ACCA

PAPER F3
FINANCIAL ACCOUNTING
(INTERNATIONAL STREAM)

STUDY SYSTEM
VOLUME 1
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Introduction

This Study System, which is presented in two volumes, has been specifically written for The Association of Chartered Certified Accountants Part 1, Paper F3 *Financial Accounting (FA)*.

Volume 1 covers the International Bookkeeping (IBK) aspects of Paper F3.

Volume 2 covers the accounting aspects including certain International Financial Reporting Standards (IFRSs) (included International Accounting Standards (IASs)).

It provides comprehensive coverage of the core syllabus areas and is designed to be used both as a reference text and interactively with the ATC Learning System to provide you with the knowledge, skill and confidence to succeed in your ACCA studies.

SYLLABUS

Aim

To develop knowledge and understanding of the underlying principles and concepts relating to financial accounting and technical proficiency in the use of double-entry accounting techniques including the preparation of basic financial statements.

Main capabilities

On successful completion of this paper, candidates should be able to:

- explain the context and purpose of financial reporting;
- define the qualitative characteristics of financial information and the fundamental bases of accounting;
- demonstrate the use of double-entry and accounting systems;
- record transactions and events;
- prepare basic financial statements for incorporated and unincorporated entities.
Position of the paper in the overall syllabus

No prior knowledge is required before commencing study for Paper F3.


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F1 Accounting in Business (AB) has only an indirect relationship with F3.
Overview

CONTEXT OF FINANCIAL REPORTING

- Context of financial reporting
- The regulatory framework

QUALITATIVE CHARACTERISTICS AND FUNDAMENTAL BASES

- Conceptual framework
- Alternative bases
- Accounting policies

TRANSACTIONS AND EVENTS

- Sales, purchases and cash
- Receivables and payables
- Accruals and prepayments
- Inventory
- Tangible non-current assets and depreciation
- Intangible non-current assets and amortisation
- Provisions and contingencies
- Capital structure and finance costs

DOUBLE-ENTRY ACCOUNTING SYSTEMS

- Double entry book-keeping principles and sources of information
- Ledger accounts
- Books of prime entry
- Journals
- Accounting systems

TRIAL BALANCE

- Trial balance
- Correction of errors
- Control accounts and reconciliations
- Bank reconciliations
- Suspense accounts

FINANCIAL STATEMENTS

- Events after the reporting period
- Incomplete records
- Accounting for partnerships
- Incorporated entities
- Statement of cash flows
Syllabus content

**A  The context and purpose of financial reporting**
- The reasons for and objectives of financial reporting
- Users’ and stakeholders’ needs
- The main elements of financial reports
- The regulatory framework

**B  Qualitative characteristics of financial information and the fundamental bases of accounting**
- The qualitative characteristics of financial reporting
- Alternative bases used in the preparation of financial information

**C  The use of double entry and accounting systems**
- Double entry book-keeping principles including the maintenance of accounting records and sources of information
- Ledger accounts, books of prime entry and journals
- Accounting systems and the impact of information technology on financial reporting

**D  Recording transactions and events**
- Sales and purchases
- Cash
- Inventory
- Tangible non-current assets
- Depreciation
- Intangible non-current assets and amortisation
- Accruals and prepayments
- Receivables and payables
- Provisions and contingencies
- Capital structure and finance costs

**E  Preparing a trial balance**
- Trial balance
- Correction of errors
- Control accounts and reconciliations
- Bank reconciliations
- Suspense accounts

**F  Preparing basic financial statements**
- Statements of financial position
- Statements of comprehensive income
- Events after the reporting period
- Accounting for partnerships
- Statements of cash flows (excluding partnerships)
- Incomplete records
**Approach to examining the syllabus**

**ACCA external examination**

The syllabus is assessed by a two hour paper-based or computer-based examination (CBE). Multiple choice questions (MCQs) will assess all parts of the syllabus and will contain both computational and non computational elements. The examination will consist of 40 two mark questions, and 10 one mark questions.

**ATC internally assessed examination**

The paper-based examination is a two hour paper constructed in two sections. Both sections will draw from all parts of the syllabus and will contain both computational and discursive elements.

<table>
<thead>
<tr>
<th>Section A: 18-20 compulsory MCQs (1-2 marks each)</th>
<th>Number of marks</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>33</td>
<td>50</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section B: 4 compulsory questions (6-12 marks each)</th>
<th>Number of marks</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>34</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>67</td>
<td>100</td>
</tr>
</tbody>
</table>
EXAMINABLE DOCUMENTS

Knowledge of new examinable regulations issued by 30th September will be required in examination sessions being held in the following calendar year. Documents may be examinable even if the effective date is in the future.

The documents listed as being examinable are the latest that were issued prior to 30th September 2008 and will be examinable in June and December 2009 examination sessions.

Students are advised to read the “Exam Notes”, published in student accountant as these contain details of examinable legislation, the list of examinable document, changes in the syllabuses and other useful information. This publication has a technical section and a “noticeboard” which are particularly relevant.

<table>
<thead>
<tr>
<th>IAS</th>
<th>Title</th>
<th>Volume 2 Study Session in which covered</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Presentation of Financial Statements</td>
<td>3</td>
</tr>
<tr>
<td>2</td>
<td>Inventories</td>
<td>7</td>
</tr>
<tr>
<td>7</td>
<td>Statement of Cash Flows</td>
<td>14</td>
</tr>
<tr>
<td>8</td>
<td>Accounting Policies, Changes in Accounting Estimates and Errors</td>
<td>13</td>
</tr>
<tr>
<td>10</td>
<td>Events After the Reporting Period</td>
<td>9</td>
</tr>
<tr>
<td>16</td>
<td>Property, Plant and Equipment</td>
<td>6</td>
</tr>
<tr>
<td>18</td>
<td>Revenue</td>
<td>4</td>
</tr>
<tr>
<td>37</td>
<td>Provisions, Contingent Liabilities and Contingent Assets</td>
<td>8</td>
</tr>
<tr>
<td>38</td>
<td>Intangible Assets</td>
<td>5</td>
</tr>
<tr>
<td>Other</td>
<td>Framework for the Preparation and Presentation of Financial Statements</td>
<td>2</td>
</tr>
</tbody>
</table>
EXAMINATION TECHNIQUE

General

➢ Divide your time in proportion to the marks on offer:

⇒ To allocate your time to ACCA MCQ exams a 2 mark question should take you just a little over 2½ minutes.

⇒ To allocate your time to ATC accredited exams multiply the marks for each question by 1.8 minutes.

For example, a 9 mark questions should take you $9 \times 1.8 = 16$ minutes. 2 mark MCQs should take, on average, about 3½ minutes.

➢ Keep to this time allocation.

➢ Answer all questions.

Multiple choice questions (MCQs)

➢ ACCA’s Knowledge paper examinations consist wholly of MCQs. In ATC’s Accredited courses, MCQs will be encountered in coursework and the final examination.

➢ MCQs mostly consist of:

⇒ a “stem” (the question);
⇒ a “key” (the correct answer);
⇒ 3 “distracters” (plausible but incorrect answers).

Commentary

Some 1 mark MCQs may have only 2 distracters or be of the “true/false” type.
OVERVIEW

Objective

➢ To explain and reconcile control accounts.
1 CONTROL ACCOUNTS

1.1 Relationship with double entry – recap

- Relevant transactions are posted twice:
  - In total to control account in general ledger; AND
  - Individually to trade receivables/trade payables ledger accounts kept in memorandum.

*Books of prime entry*

- CASH BOOK RECEIPTS
- CASH BOOK PAYMENTS
- SALES DAY BOOK
- PURCHASES DAY BOOK
- JOURNAL

*Ledges*

- GENERAL
- TRADE RECEIVABLES
- TRADE PAYABLES

DOUBLE ENTRIES – SINGLE ENTRIES

(Similar entries will be made from the sales and purchases returns books)

In memorandum
1.2 Purpose of control accounts

- To provide an internal control (also called “internal check”) over the recording of credit transactions and their subsequent settlement.

  - If all postings are correct both individually and in total ⇒
  - $\sum$ individual balances in sub-ledger = balance on control a/c
  - If errors in control a/c (kept in G/L) ⇒ Trial balance will not balance
  - If errors in individual a/c (kept in memorandum) ⇒
    - over/(under *) payments to suppliers
    - under/(over *) receipts from customers.
    - * less likely

- Control a/c reconciliations identify errors for correction.
1.3 Procedure for agreeing control a/c to memorandum ledger

- Balance off individual a/cs in the sub-ledger.
- Extract a list of a/c balances and total it.
- Balance control a/c.
- Investigate any difference.

1.4 Reasons for difference

- Casting error (i.e. an adding up a total) in a book of prime entry (affects only the total) will give rise to an error in the control account.
- Omission or duplicate posting of individual transactions.
- Transposition errors (in individual amounts or totals) will result in errors (in the individual and control accounts respectively).
- “Contra entries” (set-offs) in individual accounts not recorded in control accounts.

Commentary

Contra entries may arise when a business has accounts in both the receivables and payables ledgers for the same party (i.e. the business obtains supplies from a customer). Instead of exchanging cheques, the accounts are settled by setting off the smaller balance to leave a net amount owing.

- Bad debts in individual a/cs not recorded in control a/c.
- Casting error in balancing off a/cs (individual or total).
- Errors in extracting individual balances (= list):
  - omission;
  - recording Cr balance † in trade receivables ledger as Dr;
  - recording Dr balance in trade payables ledger as Cr.

† It is easily assumed that all receivables should have debit (or nil) balances. However, a customer could have a credit balance, e.g. if they made an advance payment.

Commentary

Remember that not all errors will give rise to a difference (e.g. omitting a transaction from a book of prime entry).
1.5 Agreement

Step 1 Identify reasons for differences (above).

Step 2 Identify control a/c adjustments ⇒ adjust control a/c.

Step 3 Adjust list of balances for errors in its make-up and extraction.

2 TRADE RECEIVABLES

2.1 Proforma

A trade receivables ledger control account may contain any or all of the following totals for the period.

<table>
<thead>
<tr>
<th>Trade receivables ledger control a/c</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance b/f (opening trade receivables) x</td>
<td>Cash a/c (cash book)</td>
<td>x</td>
</tr>
<tr>
<td>Sales (credit) a/c (sales day book) x</td>
<td>Discounts allowed a/c (cash book)</td>
<td>x</td>
</tr>
<tr>
<td>Cash a/c – dishonoured cheques (cash book) x</td>
<td>Sales returns a/c (sales returns day book)</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Bad debts expense a/c (journal)</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Credit notes (journal)</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Trade payables ledger contra (journal)</td>
<td>x</td>
</tr>
<tr>
<td></td>
<td>Balance c/f † (closing trade receivables)</td>
<td>x</td>
</tr>
<tr>
<td>Bal b/f</td>
<td>x</td>
<td>x</td>
</tr>
</tbody>
</table>

Commentary

The source of the totals is given below the narrative for the other side of the double entry.

† This balance must be the same as the sum of the individual balances extracted from the memorandum of customers’ ledger a/cs (see Illustration 1 at the end of the previous Session 12). Any difference must be reconciled.
2.2 Reconciliation For example, for trade receivables:

<table>
<thead>
<tr>
<th>Trade receivables ledger control a/c</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance b/f x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjustments x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>eg dishonoured cheque x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>eg contra</td>
<td></td>
<td></td>
</tr>
<tr>
<td>sales returns x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>x</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Statement reconciling the control account to the list of balances

<table>
<thead>
<tr>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total per list of individual a/c balances x</td>
</tr>
<tr>
<td>Add: eg balance omitted x</td>
</tr>
<tr>
<td>Less: eg balance posted twice (x)</td>
</tr>
<tr>
<td>Balance per trade receivables ledger control account x</td>
</tr>
</tbody>
</table>

These do not agree therefore something has gone wrong

Balances now agree

Illustration 1

Receivables’ ledger control a/c balance (in general ledger) $12,360

Total of the list of balances extracted from the receivables ledger $12,375

The following errors have been discovered (Step 1 to agreeing).

Where adjustment required

1. A contra of $75 between the receivables’ and payables’ ledgers is not shown in the control a/c. Control a/c

2. A debit balance of $100 has been omitted from the list of balances. List of balances

3. A credit balance of $25 has been extracted as a debit. List of balances

4. The sales day book is undercast by $50. Control a/c

5. $120 sales invoice recorded correctly in the sales day book but posted as $210. List of balances
Solution

- **Step 1**

  Adjustments to the control a/c (see above) will require double entries to be made (except where the error is made in determining the balance on the control a/c).

- **Step 2**

  Receivables ledger control a/c

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance b/d</td>
<td>12,360</td>
<td>(4) SDB undercast</td>
<td>50</td>
</tr>
<tr>
<td>(4) SDB undercast</td>
<td>50</td>
<td>Balance c/d</td>
<td>12,335</td>
</tr>
<tr>
<td></td>
<td>12,410</td>
<td></td>
<td>12,410</td>
</tr>
<tr>
<td>Balance b/d</td>
<td>12,335</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- **Step 3**

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original listing</td>
<td>12,375</td>
</tr>
<tr>
<td>(2) Balance omitted</td>
<td>100</td>
</tr>
<tr>
<td>(3) Cr balance incorrectly extracted (2 × 25)</td>
<td>(50)</td>
</tr>
<tr>
<td>(5) Transposition error</td>
<td>(90)</td>
</tr>
<tr>
<td>Adjusted list of balances total</td>
<td>12,335</td>
</tr>
</tbody>
</table>

**Commentary**

*The mechanics of payables ledger control a/c reconciliations are the same.*
Example 1

At 30 September the balance on the trade receivables ledger control a/c, that is maintained in the general ledger, was $7,655. The total of the list of balances extracted amounted to $7,580.

The following errors have been discovered.

1. An invoice for $560 has been correctly recorded in the sales day book – but recorded in the individual customer’s a/c as $650.
2. A contra of $190 recorded in the individual accounts has been omitted from the control a/c.
3. Discounts in the individual accounts amounting to $135 have not been recorded in the control a/c.
4. The sales day book was undercast by $100.
5. A credit balance of $30 was extracted as a debit balance.

Required:

Reconcile the control account balance to the total of the list of balances.

Solution

- Step 1 Identify the trade receivables ledger control a/c adjustments
- Step 2 Adjust the control a/c
Step 3 Adjust the list of balances

Original listing
(1) Transposition (560 – 650)
(2) Credit balance wrongly treated (2 × 30)

Balance per control a/c (as adjusted for errors)

3 TRADE PAYABLES

3.1 Proforma

A trade payables ledger control account may contain any or all of the following totals for the period.

<table>
<thead>
<tr>
<th>Trade payables ledger control a/c</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash a/c (cash book) x</td>
<td></td>
<td>Balance b/f (opening trade payables) x</td>
</tr>
<tr>
<td>Discounts received a/c (CB) x</td>
<td></td>
<td>Purchases (credit) a/c (PDB) x</td>
</tr>
<tr>
<td>Purchase returns a/c (PDB) x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase returns a/c (PDB) x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade receivables ledger contra (journal) x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance c/f (closing trade payables) x</td>
<td></td>
<td></td>
</tr>
<tr>
<td>x</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>x</td>
<td></td>
<td>x</td>
</tr>
<tr>
<td>Balance c/f</td>
<td></td>
<td>x</td>
</tr>
</tbody>
</table>

Commentary

The mechanics of payables ledger control a/c reconciliations are the same as for receivables.
FOCUS

You should now be able to:

- understand the purpose of control accounts for accounts receivable and accounts payable;
- understand how control accounts relate to the double entry system;
- prepare ledger control accounts from given information;
- perform basic control account reconciliations for accounts receivable and accounts payable; and
- identify errors which would be highlighted by performing a control account reconciliation and correct errors in control accounts.
EXAMPLE SOLUTION

Solution 1 – Trade receivables control a/c reconciliation

Step 1 Identify the trade receivables ledger control a/c adjustments

(1) There is no adjustment to the control a/c as the error is in the posting of an individual invoice.

(2) The effect of a contra between amounts owed and amounts owing is to reduce both, i.e.:

\[
\begin{align*}
\text{Dr} & \quad \text{Trade payables control a/c} \quad 90 \\
\text{Cr} & \quad \text{Trade receivables control a/c} \quad 90
\end{align*}
\]

(3) Discounts allowed reduce the amount owed:

\[
\begin{align*}
\text{Dr} & \quad \text{Discounts allowed a/c} \quad 135 \\
\text{Cr} & \quad \text{Trade receivables control a/c} \quad 135
\end{align*}
\]

(4) To undercast is to total to less than it should be, therefore:

\[
\begin{align*}
\text{Dr} & \quad \text{Trade receivables control a/c} \quad 100 \\
\text{Cr} & \quad \text{Revenue a/c} \quad 100
\end{align*}
\]

(5) This is an error in calculating the total of the list of balances.

In summary, items (2), (3) & (4) require adjustments to the control a/c.

Commentary

The above journals and explanations are provided to explain the items that need adjustment. They should not be reproduced to answer a question unless they are specifically required.

Step 2 Adjust the control a/c

<table>
<thead>
<tr>
<th>Trade receivables ledger control a/c</th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance b/f</td>
<td>7,655</td>
<td>(2) Payables ledger control a/c</td>
</tr>
<tr>
<td>(4) SDB - u/cast error</td>
<td>100</td>
<td>(3) Discounts allowed</td>
</tr>
<tr>
<td>Balance c/f</td>
<td>7,430</td>
<td></td>
</tr>
<tr>
<td>7,755</td>
<td>7,755</td>
<td></td>
</tr>
<tr>
<td>Balance b/f</td>
<td>7,430</td>
<td></td>
</tr>
</tbody>
</table>
### Step 3 Adjust the list of balances

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original listing</td>
<td>$7,580</td>
</tr>
<tr>
<td>(1) Transposition (560 – 650)</td>
<td>(90)</td>
</tr>
<tr>
<td>(2) Credit balance wrongly treated (2 × 30)</td>
<td>(60)</td>
</tr>
<tr>
<td><strong>Balance per control a/c (as adjusted)</strong></td>
<td>$7,430</td>
</tr>
</tbody>
</table>