

## PRINCIPLES OF ACCOUNTS

### ADVANCED LEVEL

#### OBJECTIVES

The examination aims to test the candidates' abilities to:

1. demonstrate knowledge of accounting procedures and practices and an understanding of accounting principles on which they are based;
2. apply such knowledge and understanding to familiar and novel situations;
3. analyze data and present information in an appropriate accounting form; and
4. evaluate a given scenario with reasoned explanations and make recommendations based on accounting information and principles.

#### THE EXAMINATION

The examination will consist of two papers of three hours each. Each paper will have two sections: Section A consisting of two compulsory questions of 30 marks each, and Section B a choice of two out of three questions of 20 marks each. The content of the syllabus will be tested on both papers.

#### THE SYLLABUS

Candidates are encouraged to keep abreast of the latest accounting developments in Hong Kong. Any definition or accounting practice which has become obsolete before the commencement of the teaching year of the syllabus (i.e. the September two years before the examination) will not be accepted in the examination.

##### *Syllabus*

##### *Explanatory Notes*

#### **I. THE ACCOUNTING SYSTEM**

1. Purposes of financial reporting
  - (a) Users and their information needs
  - (b) An introduction to the regulatory framework of accounting

*Syllabus**Explanatory Notes*

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| 2. | Accounting principles and concepts | (c) Uses and limitations of conventional financial statements  |
|    |                                    | (a) Meanings and implications of ‘true and fair view’ and ‘substance over form’  |
|    |                                    | (b) Meaning, importance, functions and shortcomings of:<br>entity, going concern, stable monetary unit, historical cost, accrual, prudence, consistency, objectivity, timeliness, materiality, uniformity, relevance, disclosure |
| 3. | Books of accounts and records      | (a) Double-entry book-keeping  |
|    |                                    | (b) Books of original entries  |
|    |                                    | (c) Ledgers and their classifications  |
|    |                                    | (d) Information technology applications in accounting systems  |
| 4. | Control systems                    | (a) Trial balance  |
|    |                                    | (b) Control accounts and their reconciliation with personal ledgers  |
|    |                                    | (c) Bank reconciliation statement  |
|    |                                    | (d) Types of errors and their correction   |

**II. FINANCIAL ACCOUNTING**

1. Preparation of final accounts for the following types of business:
  - sole proprietorship
  - partnership
  - limited companies
  - non-trading organizations

*Syllabus**Explanatory Notes*

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| 2. | Balancing day adjustments relating to the preparation of final accounts | <ul style="list-style-type: none"> <li>(a) Prepayments and accruals for revenue and expenses</li> <li>(b) Allowance for doubtful debts</li> <li>(c) Depreciation               <ul style="list-style-type: none"> <li>(i) Causes</li> <li>(ii) Methods:   Straight-line<br/>                  Reducing-balance<br/>                  Sum-of-the-years-digits<br/>                  Units of production</li> <li>(iii) Disposal of property, plant and equipment</li> </ul> </li> </ul>  |
| 3. | Accounting for changes in partnership                                   | <ul style="list-style-type: none"> <li>(a) Valuation and accounting treatments of goodwill</li> <li>(b) Admission and/or retirement of partner(s)</li> <li>(c) Dissolution of partnership (Piecemeal realization is not required)</li> </ul>  |
| 4. | Accounting for limited liability company                                | <ul style="list-style-type: none"> <li>(a) Types and raising of capital<br/>(Issues payable by instalments and forfeiture of shares are excluded)</li> <li>(b) Limited company taking over a sole proprietorship or a partnership<br/>(Pre-incorporation profit is not required)</li> <li>(c) Consolidated accounts (one subsidiary and acquisition method only)               <ul style="list-style-type: none"> <li>▪ minority interest</li> <li>▪ goodwill arising on consolidation (including the basic accounting treatment of subsequent impairment)</li> <li>▪ pre-acquisition and post-acquisition profits</li> <li>▪ inter-company transactions: trading of goods, property, plant and equipment; borrowing; dividend received/receivable; remittances<br/>(Accounting treatment for preference shareholding in subsidiary is not required)</li> </ul> </li> <li>(d) Published accounts (Interpretation and explanation only)</li> </ul> |

*Syllabus**Explanatory Notes*

5. Preparation of financial statements from incomplete records

**III. ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS**

1. Cash flow statement
  - (a) Functions
  - (b) Preparation of statement and notes  
(Consolidated cash flow statement is not required)
2. Ratio analysis
  - (a) Calculation of accounting ratios
  - (b) Uses and limitations of ratio analysis
3. Evaluation of profitability, liquidity, management efficiency, investment return, and financial stability

**IV. AN INTRODUCTION TO MANAGERIAL ACCOUNTING**

1. Costing principles and systems
  - (a) Introducing managerial accounting  
(Entries for interlocking cost accounting system are not required)
  - (b) Costing for materials, labour and overheads
  - (c) Preparation of manufacturing account
  - (d) Costing systems: job costing, process costing, and activity-based costing  
(Costing of normal and abnormal losses is required but costing of by-products and waste products is excluded)
  - (e) Marginal costing Vs absorption costing
  - (f) Cost-volume-profit (CVP) analysis (marginal costing only)

*Syllabus**Explanatory Notes*

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| 2.                          | Standard costing     | <ul style="list-style-type: none"> <li>(a) Establishing cost standards</li> <li>(b) Preparation of trading and profit and loss account under standard costing system (including treatment of variances)</li> <li>(c) Variance analysis               <ul style="list-style-type: none"> <li>i. Sales - sales price variance and sales volume variance</li> <li>ii. Direct materials - material price variance and material usage variance</li> <li>iii. Direct labour - wage rate variance and labour efficiency variance</li> </ul>               (Analysis of overhead variance and calculation of sales mix and material mix variances are excluded)             </li> </ul> |
| 3.                          | Budgeting            | <ul style="list-style-type: none"> <li>(a) Advantages and uses</li> <li>(b) Fixed Vs flexible budgets</li> <li>(c) Factors to consider in setting and revising budgets</li> <li>(d) Cash budgets</li> <li>(e) Budgeted profit and loss accounts and balance sheets</li> </ul>   |
| 4.                          | Investment appraisal | <ul style="list-style-type: none"> <li>(a) Financial factors affecting investment decisions               <ul style="list-style-type: none"> <li>— ascertainment of future cash flows, payback, and accounting rate of return</li> <li>— net present value and internal rate of return (Calculation of IRR is not required)</li> </ul> </li> <li>(b) Non-financial factors affecting investment decisions</li> </ul>  |
| <b>V. ACCOUNTING THEORY</b> |                      |   |
| 1.                          | Income determination | <ul style="list-style-type: none"> <li>(a) Concepts of revenue and its recognition</li> </ul>   |

*Syllabus**Explanatory Notes*

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|    |  | (b) Concepts of expenses and its measurement  |
|    |  | (c) Prior-period adjustments  |
| 2. | Valuation of property, plant and equipment | (a) Distinction between capital and revenue expenditure   |
|    |  | (b) Valuation concepts and methods: historical cost Vs fair value<br>(Impairment of property, plant and equipment is excluded.)                 |
|    |  | (c) Concepts, reasons and methods of depreciation   |
|    |  | (d) Accounting for leases (lessee only)   |
| 3. | Valuation of intangible assets             | (a) Nature and characteristics of intangible assets such as patents,<br>copyrights, franchises, research and development costs, trademark, etc. |
|    |  | (b) Valuation concepts and methods  |
|    |  | (c) Accounting treatment  |
| 4. | Valuation of inventories                   | (a) Periodic Vs perpetual inventory system  |
|    |  | (b) Inventory valuation methods (based on historical cost valuation)  |
|    |  | — specific identification   |
|    |  | — average cost  |
|    |  | — first in, first out   |
|    |  | — last in, first out  |
|    |  | (c) The lower of cost and net realizable value  |