

UNIT 10: FINANCIAL ACCOUNTING



Illustration by Chris Gash

- UNIT 10: A/508/0496
- CREDIT VALUE: 15

FINANCIAL ACCOUNTING



- LO 4: Reconcile control accounts and shift recorded transactions from the suspense accounts to the right accounts

THE BASIC SYLLABUS



- 1. Record Business transactions using double entry book keeping, and be able to extract a trial balance.
- 2. Prepare final accounts for sole-traders, partnerships and limited companies in accordance with appropriate principles, conventions and standards.
- 3. Perform bank reconciliations to ensure company and bank records are correct.
- 4. Reconcile control accounts and shift recorded transactions from the suspense accounts to the right accounts

LEARNING OUTCOMES



- At the end of the class the students should be able to:

OVERVIEW



- A control account is an account in the nominal ledger in which a record is kept of the total value of a number of similar but individual items.
- Suspense accounts, as well as being used to correct some errors, are also opened when it is not known immediately where to post an amount. When the mystery is solved, the suspense account is closed and the amount correctly posted using a journal entry.

CONTROL ACCOUNT

- A control account keeps a total record of a number of individual items. It is an impersonal account which is part of the double entry system. Control accounts are used chiefly for trade receivables and payables.
- - A receivables control account is an account in which records are kept of transactions involving all receivables in total. The balance on the receivables control account at any time will be the total amount due to the business at that time from its receivables.
- - A payables control account is an account in which records are kept of transactions involving all payables in total, and the balance on this account at any time will be the total amount owed by the business at that time to its payables.

PURPOSE OF CONTROL ACCOUNTS

- The reasons for having control accounts are as follows.
- (a) They provide a check on the accuracy of entries made in the personal accounts in the receivables ledger and payables ledger. It is very easy to make a mistake in posting entries, because there might be hundreds of entries to make. Figures can get transposed. Some entries might be omitted altogether, so that an invoice or a payment transaction does not appear in a personal account as it should. By comparing (i) and (ii) below, it is possible to identify that fact that errors have been made.
- (i) The total balance on the receivables control account with the total of individual balances on the personal accounts in the receivables ledger.
- (ii) The total balance on the payables control account with the total of individual balances on the personal accounts in the payables ledger.

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PURPOSE OF CONTROL ACCOUNTS

- (b) The control accounts also assist in the location of errors, where postings to the control accounts are made daily or weekly, or even monthly. If a clerk fails to record an invoice or a payment in a personal account, or makes a transposition error, it would be a formidable task to locate the error or errors at the end of a year, say, given the number of transactions. By using the control account, a comparison with the individual balances in the receivables or payables ledger can be made for every week or day of the month, and the error found much more quickly than if control accounts did not exist.

PURPOSE OF CONTROL ACCOUNTS

- (c) Where there is a separation of clerical (bookkeeping) duties, the control account provides an internal check. The person posting entries to the control accounts will act as a check on a different person(s) whose job it is to post entries to the receivables and payables ledger accounts.
- (d) To provide total receivables and payables balances more quickly for producing a trial balance or statement of financial position. A single balance on a control account is obviously extracted more simply and quickly than many individual balances in the receivables or payables ledger. This means also that the number of accounts in the double entry bookkeeping system can be kept down to a manageable size, since the personal accounts are memorandum accounts only.

Illustrative control accounts

Receivables ledger control account

Balance b/f	X	Balance b/f	X
Credit sales (SDB)	X	Sales returns (SRDB)	X
		Bank (CB)	X
Bank (CB) dishonoured cheques	X	Irrecoverable debts (journal)	X
Bank (CB) refunds of credit balances	X	Discounts allowed	X
Interest charged	X	Contra	X
Balance c/f	X	Balance c/f	X
	<hr/>		<hr/>
	X		X
	<hr/>		<hr/>
Balance b/f	X	Balance b/f	X

Payables ledger control account

Balance b/f	X	Balance b/f	X
Bank (CB)	X	Credit purchases (PDB)	X
Purchases returns (PRDB)	X	Bank (CB) refunds of debit balances	X
Discounts received	X		
Contra	X		
Balance c/f	X	Balance c/f	X
	<hr/>		<hr/>
	X		X
	<hr/>		<hr/>
Balance b/f	X	Balance b/f	X

Abbreviation key:

SDB Sales day book

PDB Purchases day book

SRDB Sales returns day book

PRDB Purchases returns day book

CB Cash book

CONTROL ACCOUNT RECONCILIATIONS

- The reconciliation is a working to ensure that the entries in the sales and purchase ledgers (the memorandums, or list of individual balances) agree with the entries in the control accounts. The totals in each should be exactly the same. If not it indicates an error in either the memorandum account or the control account. All discrepancies should be investigated and corrected.

CONTROL ACCOUNT RECONCILIATIONS

- Preparing a control account reconciliation
- The format of a control account reconciliation, in this case for receivables, is as follows:

Receivables ledger control account			
	\$		\$
Balance given by the examiner	X	Adjustments for errors	X
Adjustments for errors	X	Revised balance c/f	X
	—		—
	X		X

Reconciliation of individual receivables balances with control account balance

Balance as extracted from list of receivables	\$
Adjustments for errors	X
	X/(X)
Revised total agreeing with balance c/f on control account	<u>X</u>

TYPES OF ERRORS

Error type	Suspense account involved?
1 Omission - a transaction is not recorded at all	No
2 Error of commission - an item is entered to the correct side of the wrong account (there is a debit and a credit here, so the records balance)	No
3 Error of principle - an item is posted to the correct side of the wrong type of account, as when cash paid for plant repairs (expense) is debited to plant account (asset) (errors of principle are really a special case of errors of commission, and once again there is a debit and a credit)	No
4 Error of original entry - an incorrect figure is entered in the records and then posted to the correct account Example: Cash \$1,000 for plant repairs is entered as \$100; plant repairs account is debited with \$100	No
5 Reversal of entries - the amount is correct, the accounts used are correct, but the account that should have been debited is credited and vice versa Example: Factory employees are used for plant maintenance: Correct entry: Debit: Plant maintenance Credit: Factory wages Easily done the wrong way round	No
6 Addition errors - figures are incorrectly added in a ledger account	Yes

TYPES OF ERRORS

7 Posting error

Yes

a an entry made in one record is not posted at all

b an entry in one record is incorrectly posted to another

Examples: cash \$10,000 entered in the cash book for the purchase of a car is:

a not posted at all

b posted to Motor cars account as \$1,000

8 Trial balance errors - a balance is omitted, or incorrectly extracted, in preparing the trial balance

Yes

9 Compensating errors - two equal and opposite errors leave the trial balance balancing (this type of error is rare, and can be because a deliberate second error has been made to force the balancing of the records or to conceal a fraud) Yes, to correct each of the errors as discovered

Yes, to correct each of the errors as discovered

CORRECTION OF ERRORS

- Errors 1 to 5, when discovered, will be corrected by means of a journal entry between the accounts affected. Errors 6 to 9 also require journal entries to correct them, but one side of the journal entry will be to the suspense account opened for the difference in the records. Type 8, trial balance errors, are different. As the suspense account records the difference, an entry to it is needed, because the error affects the difference. However, there is no ledger entry for the other side of the correction - the trial balance is simply amended.

CORRECTION OF ERRORS

- When correcting errors it is useful to think about:
- What double entry should have been made:
- What double entry was made?
- What is the correcting journal?
- For example: the purchase of a non-current asset costing \$100 has been recorded by debiting \$10 to the non-current assets account and crediting \$100 to cash.

CORRECTION OF ERRORS

What should the double entry have been?		What was the double entry?		Correcting journal	
Dr NCA	\$100	Dr NCA	\$10	Dr NCA	\$90
Cr Cash	\$100	Dr Suspense (bal. fig)	\$90	Cr Suspense	\$90
		Cr Cash	\$100		

Adjustments to profit

The correction journal may result in a change in profit, depending on whether the journal debits or credits the [income statement](#):

Dr Statement of financial position account Cr Statement of financial position account	No impact on profit
Dr Income statement account Cr Income statement account	No impact on profit
Dr Income statement account Cr Statement of financial position account	Profit decreases
Dr Statement of financial position account Cr Income statement account	Profit increases

For this purpose the suspense account is defined as a [statement of financial position](#) account.

SUSPENSE ACCOUNTS

- A suspense account is an account in which debits or credits are held temporarily until sufficient information is available for them to be posted to the correct accounts.
- There are two main reasons why suspense accounts may be created:
 - - On the extraction of a trial balance the debits are not equal to the credits and the difference is put to a suspense account.
 - - When a bookkeeper performing double entry is not sure where to post one side of an entry he may debit or credit a suspense account and leave the entry there until its ultimate destination is clarified.

SUSPENSE ACCOUNTS

- It must be stressed that a suspense account can only be temporary. Postings to a suspense account are
- only made when the bookkeeper doesn't know yet what to do, or when an error has occurred. Mysteries
- must be solved, and errors must be corrected. Under no circumstances should there still be a suspense
- account when it comes to preparing the statement of financial position of a business. The suspense
- account must be cleared and all the correcting entries made before the final accounts are drawn up.

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