

Financial Statements

Learning Area Overview



Welcome to this learning area overview for Financial Statements, prepared by AAT.

In this overview we'll explain what Financial Statements is all about, and how it fits into the bigger picture of the AAT Accounting Qualification.

We'll explore the main topics you can expect to cover, and how the knowledge and skills you'll pick up will be of practical use to you in the workplace.

Finally, we'll explain how this learning area relates to the others you've already studied, and those you'll study in the future.

What you'll learn in Financial Statements

In Financial Statements you'll learn how to identify who the users of financial statements are, and what they need to be able to make informed decisions.

The knowledge and understanding part of this learning area is concerned with the principles of drafting financial statements, while the skills part covers the actual drafting of those statements.

In Financial Statements you'll learn how to prepare different financial statements to meet the needs of the users. Useful information must be relevant, reliable, comparable and understandable. You'll also learn how to interpret financial statements so that you can give advice to the users of the accounts.

There are six main areas in Financial Statements.

The first area covers the regulatory framework, in which you'll learn about the various rules and regulations governing the preparation and presentation of financial statements.

These rules are contained within:

- the Companies Act
- the International Accounting Standards and International Financial Reporting Standards
- the International Accounting Standards Board Framework.

The second area looks at adjustments to the trial balance and journals. You'll already be familiar with the trial balance of a business from both level 2 and level 3. In addition, at level 3 you'll also have prepared journals for year-end adjustments.

In Financial Statements at level 4, you'll be looking at adjustments to the trial balance and journals for a limited company.

You'll learn that there are the usual year-end adjustments for closing stock, prepayments and accruals and also additional journals to adjust for items such as the Corporation Tax liability and accrued interest. There may also be journals to deal with the issue of shares or the revaluation of property.



Next, you'll learn about the preparation of financial statements for a single entity. This topic is linked to the previous one, because once you've adjusted the trial balance for the various different journal entries already mentioned, you might also have to produce either all or part of a set of financial statements for a company incorporating these adjustments. These are prepared in accordance with the rules and regulations set out in the regulatory framework.

The fourth area covers the preparation of consolidated financial statements, also known as "group accounting". Here, you'll learn how to prepare the main financial statements of a simple group of companies consisting of a parent company, and one partly owned subsidiary company.

There are some specific accounting standards governing the preparation of the financial statements of groups of companies. You'll need to apply these appropriately.

The fifth area will teach you about the statement of cash flows. Companies are required to publish a statement of cash flows. The purpose of this is to show where money that the company has received has come from, and likewise how money paid out of the company has been spent.

The sixth and final area in Financial Statements looks at performance indicators.

Calculating performance indicators – often called ratio analysis – helps accountants to interpret financial statements so that they can advise the users of the financial statements as to how the organisation is doing.

Different performance indicators are used to analyse the profitability, liquidity, efficiency and financial position of a business. However, these ratios only make sense when they're compared to some sort of base figure. This base figure can be the previous year's performance indicator; or the corresponding performance indicator of a similar business; or some kind of pre-set target.

How Financial Statements will help you in the workplace

If you work in practice for a firm of accountants, there's a good chance you'll be involved in the preparation of financial statements for a range of different businesses, whether they're sole traders, partnerships or limited companies.

Although the regulatory framework isn't as important for unincorporated businesses, their financial statements will still be prepared using UK Generally Accepted Accounting Practice (or UK GAAP for short), which is very much informed by the regulatory framework. For the preparation of limited company accounts, your firm will normally have some form of pre-prepared pro forma layouts for the financial statements.

If you don't work in public practice, then whatever business you work for you'll still need to prepare financial statements on an annual basis. As a result you should be familiar with the format of those financial statements and how they're prepared from the accounting records of the business.

If you work for a limited company you'll probably have had some interaction with external auditors, and have observed the work they do to ensure that the financial statements have been prepared accurately and in accordance with the rules.

You're perhaps less likely to be familiar with the preparation of consolidated accounts. This may be because you don't work for a parent company, or because the process of consolidation is carried out by more senior accountants in your company.

Most students also tend not to have come across statements of cash flows very often. The reason for this is usually because sole traders and partnership businesses don't need to produce them.

Hopefully the knowledge and skills you gain while completing this unit will allow you to increase your contribution at work, and give you a better opportunity to develop your accountancy career.

How Financial Statements relates to other learning areas

Financial Statements is one of the four compulsory learning areas at this level. The other compulsory learning areas are:

- Budgeting
- Financial Performance
- Internal Control and Accounting Systems.

There are also four optional learning areas at level 4, and you'll need to complete two of them. These are:

- External Auditing
- Credit Management and Control
- Personal Tax
- Business Tax.

There are two main strands to the AAT Accounting Qualification – financial accounting and management accounting. The Financial Statements learning area is part of the financial accounting strand.

Both of these strands run through all three levels of the qualification, and the knowledge and skills you build up at previous levels are developed further at level 4, where you'll learn how to prepare and interpret the financial statements of limited companies.

To do this you'll need a more in-depth understanding of the regulatory framework for accounting, along with knowledge of the layout of a range of financial statements.

The Financial Statements learning area has a few links with some of the other learning areas at this level. For instance, the Business Tax learning area will show you how to calculate the tax liability of a limited company, while in Financial Performance you'll use many of the same accounting ratios from this unit to evaluate business performance.

In External Auditing, meanwhile, you'll learn how auditors assess limited company financial statements in order to decide whether they comply with the requirements of the regulatory framework.

If you continue your accountancy studies to level 5 and beyond by studying for one of the professional accounting qualifications, or for a degree in accountancy, then Financial Statements will give you a good grounding to take forward to your future financial accounting exams.

If you study for a higher level qualification, you'll continue to study both financial and management accounting.