

DRAFTING AND INTERPRETING FINANCIAL STATEMENTS

STUDY TEXT

Qualifications and Credit Framework

Q2022

This Study Text supports study for the following AAT qualifications:

AAT Level 4 Diploma in Professional Accounting

AAT Diploma in Professional Accounting at SCQF Level 8

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INTRODUCTION

HOW TO USE THESE MATERIALS

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chance of success in your AAT assessments.

They contain a number of features to help you in the study process.

The sections on the Unit Guide, the Assessment and Study Skills should be read before you commence your studies.

They are designed to familiarise you with the nature and content of the assessment and to give you tips on how best to approach your studies.

STUDY TEXT

This study text has been specially prepared for the revised AAT qualification introduced in February 2022.

It is written in a practical and interactive style:

- key terms and concepts are clearly defined
- all topics are illustrated with practical examples with clearly worked solutions based on sample tasks provided by the AAT in the new examining style
- frequent practice activities throughout the chapters ensure that what you have learnt is regularly reinforced
- 'pitfalls' and 'examination tips' help you avoid commonly made mistakes and help you focus on what is required to perform well in your examination
- 'Test your understanding' activities are included within each chapter to apply your learning and develop your understanding.

ICONS

The chapters include the following icons throughout.

They are designed to assist you in your studies by identifying key definitions and the points at which you can test yourself on the knowledge gained.



Definition

These sections explain important areas of Knowledge which must be understood and reproduced in an assessment.



Example

The illustrative examples can be used to help develop an understanding of topics before attempting the activity exercises.



Test your understanding

These are exercises which give the opportunity to assess your understanding of all the assessment areas.



Foundation activities

These are questions to help ground your knowledge and consolidate your understanding on areas you're finding tricky.



Extension activities

These questions are for if you're feeling confident or wish to develop your higher level skills.

Quality and accuracy are of the utmost importance to us so if you spot an error in any of our products, please send an email to mykaplanreporting@kaplan.com with full details.

Our Quality Co-ordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

Regulatory frameworks

1

Introduction

In this initial chapter we will be covering background information that is essential for your understanding of the preparation of financial statements for many types of organisation, in particular for limited companies.

ASSESSMENT CRITERIA

The regulatory framework that underpins financial reporting (1.1)

The International Accounting Standards Board (the Board) Conceptual Framework for Financial Reporting ('the Framework') (1.2)

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- 1 Introduction
- 2 The purpose of financial statements
- 3 The legal framework
- 4 Accounting standards

1 Introduction

1.1 Background knowledge

In previous units of your accounting studies you were introduced ledger accounting, and progressed on to preparation of an extended trial balance. When preparing an extended trial balance you would have made a number of adjustments for items such as inventories, accruals, prepayments, depreciation, irrecoverable debts and allowances for receivables. Each account on the extended trial balance was then balanced and extended into either the statement of profit or loss columns or the statement of financial position columns depending upon whether the account was an item of income, expense, an asset, a liability or equity/capital.

In this unit, your knowledge of financial accounting will be developed further.

1.2 Drafting financial statements

This unit includes the drafting of the relevant financial statements for limited companies. You must be able to prepare a statement of financial position, statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows in accordance with all of the applicable regulations (the Companies Act 2006, accounting standards, etc.).

1.3 Interpretation of financial statements

The unit also includes interpretation of financial statements. It is concerned with being able to analyse and understand the structure and purpose of financial statements of limited companies. It requires a sound understanding of the knowledge and skills required to prepare financial statements and an ability to interpret the relationships between the various components of the financial statements by using ratio analysis.

In order to understand and interpret limited company financial statements you must be able to understand how they have been prepared. Therefore your knowledge from Bookkeeping Transactions and Advanced Bookkeeping is extremely important as the knowledge and skills from these units will assist you to understand how the financial statements of limited companies are prepared.

In this chapter and the next, however, we will consider the background to the preparation of financial statements for limited companies by considering the regulatory framework and then the Conceptual Framework for Financial Reporting ('the Framework') within which financial statements are prepared.

4 Accounting standards

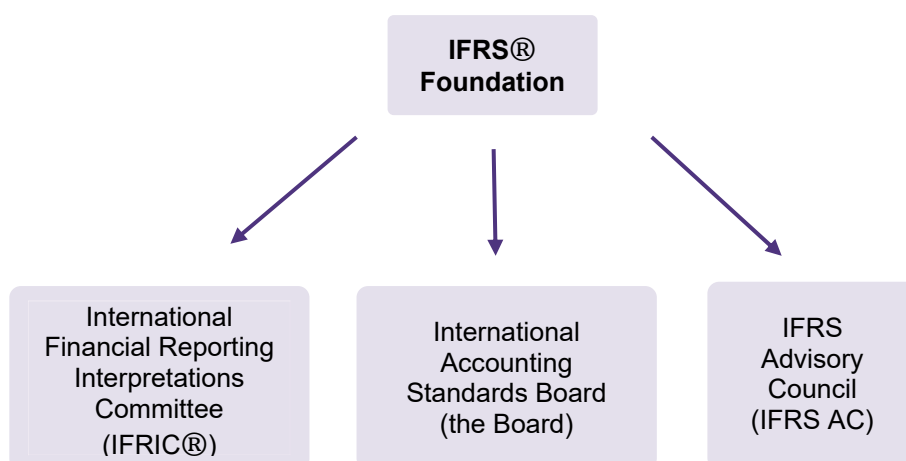
4.1 IFRS Standards and IAS Standards

Accounting standards give guidance in specific areas of accounting. The Financial Statements syllabus follows International standards which consist of the following:

- International Financial Reporting Standards (IFRS® Standards)**
 IFRS Standards are issued by the International Accounting Standards Board (the Board). Many countries have used IFRS Standards for some years. In 2002, the Council of Ministers of the European Union (EU) decided that any company which is listed on a European Stock Exchange must prepare their consolidated accounts in accordance with IFRS Standards with effect from 1 January 2005.
- International Accounting Standards (IAS® Standards)**
 IAS Standards were created by the International Accounting Standards Committee (IASC) which was the predecessor of the Board. When the Board was formed it adopted the IAS Standards then in issue. Subsequently, many IAS Standards have been withdrawn and superseded by IFRS Standards, although some remain in issue.

4.2 The structure of the regulatory bodies

The structure of the International Financial Reporting Standards Foundation and its subsidiary bodies is shown below:





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