

VU LEARNING HUB

vulearninghub.xyz

HIGHLIGHTED HANDOUT

FIN711

Advanced Financial Accounting

FIN711 by VU Learning HUB

Prepared for VU students • Free study resources

<https://vulearninghub.xyz>

FIN711

Advanced Financial Accounting

Lecture Handouts

Prepared for the students of Virtual University of Pakistan

Table of Contents

Placeholder for table of contents	0
-----------------------------------	---

1. The Financial Reporting Framework

LEARNING OBJECTIVES

- Explain the IASB Conceptual Framework
- State the qualitative characteristics of useful information
- Define the elements of financial statements

The **IASB Conceptual Framework** underpins all IFRS: the objective of financial reporting is to provide information useful for **economic decisions** (investing, lending) by assessing future cash flows. **Fundamental qualitative characteristics:** **relevance** (predictive and confirmatory value, materiality) and **faithful representation** (complete, neutral, free from error). Enhancing characteristics: comparability, verifiability, timeliness, understandability. The cost constraint: benefits must exceed costs.

Elements: **asset** (present economic resource controlled from past events, with potential to produce economic benefits), **liability** (present obligation to transfer economic resources), **equity** (residual interest), **income** (increases in assets/decreases in liabilities raising equity, excluding owner contributions), **expenses** (decreases). **Recognition** requires meeting definitions plus measurability; **measurement bases** include historical cost, current cost, realizable value and present value. Pakistan adopted IFRS via the ICAP/SECP framework - listed companies report under IFRS as notified.

Accrual basis

Transactions are recognized when they occur (not when cash moves) - the foundation of the matching principle and of all advanced accounting adjustments.

SECTION SUMMARY

The Framework: decision-useful information = relevant + faithfully represented. Elements defined by control/obligation; recognition and measurement follow. Pakistan reports under notified IFRS.

2. Business Combinations (IFRS 3)

LEARNING OBJECTIVES

- Explain the acquisition method
- Compute goodwill
- Account for non-controlling interests

IFRS 3 requires the **acquisition method**: (1) identify the **acquirer** (who obtains control - power over relevant activities plus exposure to variable returns, per IFRS 10); (2) determine the **acquisition date**; (3) recognize identifiable assets and liabilities at **fair value**; (4) recognize **goodwill** = consideration transferred + NCI + fair value of prior equity interest - net identifiable

assets. Goodwill captures synergies and unidentifiable intangibles; it is **not amortized** but tested annually for impairment (IAS 36).

Non-controlling interest may be measured at fair value (full goodwill method) or at proportionate share of net assets (partial goodwill). **Bargain purchases** (consideration < fair value of net assets) go to profit or loss after reassessment. Contingent consideration is recognized at fair value and remeasured. Acquisition-related costs are **expensed**, not added to consideration - a favorite exam trap. ☰

■ VERY IMPORTANT

Goodwill computation format is mechanical exam gold: Consideration (cash + shares at fair value + contingent) + NCI - fair value of identifiable net assets = Goodwill. Practice with numbers until automatic.

SECTION SUMMARY

IFRS 3: acquisition method, fair-value everything, goodwill = excess of consideration over net assets (impairment-tested, never amortized), NCI at fair value or proportionate share.

3. Consolidated Financial Statements (IFRS 10)

SECTION SUMMARY

Consolidate controlled entities line-by-line; eliminate investment vs equity, intra-group balances/sales, PUP and dividends. Associates use equity accounting; control is about power + returns.

4. Financial Instruments (IFRS 9)

LEARNING OBJECTIVES

- Classify financial assets under IFRS 9
- Explain amortized cost and expected credit losses
- Account for basic hedging

IFRS 9 classifies financial assets by **business model** + **SPPI test** (solely payments of principal and interest): **amortized cost** (hold to collect - e.g. loans; interest via effective interest method), **FVOCI** (hold to collect and sell - debt; or irrevocable election for equities), **FVTPL** (everything else, including derivatives). Financial liabilities are mostly amortized cost, except trading/derivatives at FVTPL.

The **expected credit loss (ECL)** model **replaced incurred loss: recognize 12-month ECL on good loans (stage 1), lifetime ECL on credit-impaired (stages 2-3) - forward-looking provisioning that hit Pakistani banks' profits on adoption.** Hedge accounting** (optional) matches hedging instrument gains/losses with hedged-item effects: fair-value hedges (both to P&L), cash-flow hedges (effective portion to OCI), net-investment hedges. Derecognition: transfer risks and rewards.

Effective interest method

Amortizes a financial asset/liability so that interest each period = carrying amount x effective rate
- the constant-yield allocation at IFRS 9's heart.

SECTION SUMMARY

IFRS 9: classify by business model + SPPI into amortized cost/FVOCI/FVTPL; provision via forward-looking ECL; hedge accounting aligns hedging gains with hedged risks.

5. Leases (IFRS 16)

LEARNING OBJECTIVES

- Explain the lessee's right-of-use model
- Account for lessor finance vs operating leases
- Compute lease liability and ROU asset

IFRS 16 ended off-balance-sheet operating leases for lessees: every lease (over 12 months, above low-value threshold) recognizes a **right-of-use (ROU) asset** and a **lease liability** = present value of lease payments discounted at the implicit rate (or incremental borrowing rate). Subsequent: liability accrues interest (effective interest) and reduces with payments; ROU asset depreciates - typically straight-line. The expense profile is **front-loaded** (interest + depreciation > old straight-line rent early on).

Lessors keep the old split: **finance lease** (transfers substantially all risks/rewards - recognize receivable, derecognize asset) vs **operating lease** (keep asset, recognize rental income straight-line). Sale-and-leaseback: if the transfer is a sale (IFRS 15), recognize gain only on the rights transferred. Pakistani companies' EBITDA rose on adoption (rent replaced by depreciation + interest) - a much-discussed statement effect.

SECTION SUMMARY

IFRS 16: lessees capitalize all material leases (ROU asset + PV liability); front-loaded expense pattern. Lessors still split finance vs operating leases.

6. Revenue from Contracts (IFRS 15)

LEARNING OBJECTIVES

- Apply the five-step revenue model
- Handle variable consideration and performance over time
- Distinguish principal from agent

IFRS 15's five steps: (1) identify the **contract** (enforceable, commercial substance); (2) identify **performance obligations** (distinct goods/services); (3) determine the **transaction price** (including variable consideration - estimated, constrained to avoid reversals); (4) **allocate** price by stand-alone selling prices; (5) recognize revenue **when (or as)** each obligation is satisfied - i.e. when control transfers.

Over time recognition (construction, services) needs one of: customer simultaneously receives/consumes benefit, the asset has no alternative use + enforceable right to payment, or customer controls the asset as built - measured by input/output methods (e.g. cost-to-cost). Otherwise **point in time**. **Principal vs agent:** recognize gross if you control the good before transfer (principal), net commission if you merely arrange (agent) - critical for e-commerce and travel platforms. Contract assets/liabilities replace 'accrued/unearned revenue' vocabulary.

■ VERY IMPORTANT

The five steps in order are pure exam recall; application questions give a scenario (e.g. software + installation + support) and ask you to split obligations and time the revenue.

SECTION SUMMARY

IFRS 15: 5 steps from contract to control-transfer; over-time vs point-in-time; variable consideration constrained; principal = gross, agent = net.

7. Property, Plant, Impairment and Provisions

LEARNING OBJECTIVES

- Apply IAS 16 revaluation and depreciation
- Test impairment under IAS 36
- Recognize provisions under IAS 37

IAS 16: initial recognition at cost; subsequent policy choice - **cost model** or **revaluation model** (fair value, entire class revalued, surplus to OCI). Depreciation reflects consumption pattern; component approach for significant parts (e.g. aircraft engines). **IAS 36 impairment:** compare carrying amount with **recoverable amount** (higher of fair value less costs of disposal and value in use) - at each reporting date if indicators exist; goodwill and indefinite intangibles tested annually. Impairment loss hits P&L (or revaluation surplus first); goodwill impairments **never reverse**.

IAS 37 provisions: recognize when there is a **present obligation** (legal or constructive) from a past event, **probable outflow**, and **reliable estimate** - measured at best estimate, discounted if material. Restructuring provisions need a detailed formal plan announced. **Contingent liabilities** (possible obligations) are disclosed, not recognized; contingent assets disclosed only when inflow is probable. Onerous contracts (unavoidable costs exceed benefits) must be provided for.

SECTION SUMMARY

IAS 16: cost or revaluation. IAS 36: impair to recoverable amount; goodwill never reverses. IAS 37: provide for probable present obligations; disclose contingents.

8. Employee Benefits and Share-Based Payment

LEARNING OBJECTIVES

- Distinguish defined contribution from defined benefit plans
- Account for pensions under IAS 19
- Explain IFRS 2 share-based payments

IAS 19: defined contribution plans (e.g. provident fund - employer pays fixed contributions) - expense as incurred, no actuarial risk. **Defined benefit** plans (gratuity, pension promises - common in Pakistani corporates): recognize the **net defined benefit liability** = present value of

obligation (projected unit credit method, discounting at high-quality corporate bond rates) minus plan assets; **remeasurements** (actuarial gains/losses) go to **OCI**, never recycled; service cost and net interest go to P&L.

IFRS 2: equity-settled share-based payments (employee stock options) measured at **grant-date fair value** (option-pricing models), expensed over the **vesting period** with true-ups for forfeitures; cash-settled (SARs) remeasured each period. The expense reflects services received - a real cost despite no cash outflow, which is why IFRS 2 was controversial on introduction.

SECTION SUMMARY

IAS 19: DC = pay-as-you-go; DB = PV of promise minus assets, remeasurements to OCI. IFRS 2: expense options at grant-date fair value over vesting.

9. Foreign Currency and Hyperinflation (IAS 21/29)

LEARNING OBJECTIVES

- Translate foreign operations
- Distinguish monetary from non-monetary items
- Explain hyperinflation restatement

IAS 21: each entity's **functional currency** (currency of its primary economic environment); present in any currency. **Transactions:** record at spot rate; **monetary items** (cash, receivables, payables) retranslated at closing rate with differences to P&L; non-monetary items at historical cost stay at historical rates. **Foreign operations:** assets/liabilities at **closing rate**, income/expenses at **average rate**, resulting **translation differences to OCI** (accumulated in a translation reserve, recycled on disposal).

Goodwill of a foreign subsidiary is treated as the subsidiary's asset - translated at closing rate.

IAS 29 (hyperinflation): restate non-monetary items, equity and comparatives using a general price index before translation - relevant to subsidiaries in hyperinflationary economies (not Pakistan currently). Hedging foreign investments uses net-investment hedge accounting.

SECTION SUMMARY

IAS 21: monetary items at closing rate (P&L differences); foreign subsidiaries via closing/average rates with OCI translation reserve. IAS 29 restates for hyperinflation.

10. Earnings Per Share and Segment Reporting

LEARNING OBJECTIVES

- Compute basic and diluted EPS (IAS 33)
- Identify reportable segments (IFRS 8)
- Explain interim reporting basics

IAS 33: Basic EPS = profit attributable to ordinary shareholders / weighted average ordinary shares outstanding (adjust retrospectively for bonus issues/splits). **Diluted EPS** adjusts for **dilutive potential shares** (convertible bonds, options - treasury stock method): add back after-tax interest on convertibles to earnings, add potential shares to denominator. Anti-dilutive instruments are excluded. Listed Pakistani companies must present EPS on the face of profit or loss.

IFRS 8 (management approach): reportable segments are operating segments exceeding **10% thresholds** (revenue, profit/loss, assets); disclose segment profit, assets, and reconciliations to consolidated totals. **IAS 34** interim reports use year-to-date measurement with condensed statements. Related-party disclosures (IAS 24) and events after the reporting period (IAS 10: adjusting vs non-adjusting) complete the disclosure picture.

SECTION SUMMARY

IAS 33: basic EPS on weighted shares; diluted EPS includes convertibles/options via treasury method.
IFRS 8: 10%-threshold operating segments, management approach.

11. Statement of Cash Flows and Analysis

LEARNING OBJECTIVES

- Prepare cash flow statements (IAS 7)
- Choose direct vs indirect method
- Analyze statements via ratios

IAS 7: classify flows into **operating** (direct method preferred - cash from customers/suppliers; indirect starts from profit and adjusts for non-cash items and working-capital changes), **investing** (PPE, acquisitions, investments) and **financing** (debt, equity, dividends). Interest/dividends may sit in operating or financing/investing by policy (banks: operating). Non-cash transactions (e.g. asset acquired via finance lease) are disclosed, not shown as flows.

Analysis toolkit: **profitability** (gross/net margin, ROE = net income/equity, ROA; DuPont decomposes $ROE = \text{margin} \times \text{turnover} \times \text{leverage}$), **liquidity** (current ratio, quick ratio, cash conversion cycle), **solvency** (debt/equity, interest cover), **market** (P/E, dividend yield). **Creative accounting red flags**: receivables growing faster than sales, operating cash flow diverging from profit, frequent 'exceptional' items, changing depreciation policies. Pakistani analysts watch circular-debt receivables in energy firms.

SECTION SUMMARY

IAS 7: operating/investing/financing; indirect method reconciles profit to cash. Ratios diagnose profitability, liquidity, solvency - and divergences between profit and cash flag manipulation.

12. Exam Pointers

High-yield topics

- Framework: qualitative characteristics; element definitions; recognition criteria.
- IFRS 3: goodwill computation (full vs partial); bargain purchase; acquisition costs expensed.
- Consolidation: PUP elimination, NCI, intra-group eliminations; associate = equity method.
- IFRS 9: three classifications (business model + SPPI); ECL stages; amortized cost via EIR.
- IFRS 16: ROU asset + lease liability; front-loaded expense; lessor finance vs operating.
- IFRS 15: five steps; over-time criteria; principal vs agent.
- IAS 36: recoverable amount = higher of FVLCD and VIU; no goodwill reversal. IAS 37: provision criteria.
- IAS 19: DB remeasurements to OCI. IFRS 2: grant-date fair value over vesting.
- IAS 21: monetary at closing rate; subsidiary translation to OCI. IAS 33: basic vs diluted EPS.

SECTION SUMMARY

Every standard = scope trigger + recognition rule + measurement rule + one numeric format. Practice the formats (goodwill, consolidation, EPS, cash flow) until mechanical.