Answers

1 (a) Bravado plc

Consolidated Statement of Financial Position at 31 May 2009

	$m
Assets:	
Non-current assets:	
Property, plant and equipment W9	708
Goodwill W2	25
Investment in associate W3	22·5
Available for sale financial assets W10	44·6
	800·1
Current assets:	
Inventories W10	245
Trade receivables W11	168
Loans to directors	1
Cash and cash equivalents	209
	623
Total assets	1,423·1
Equity and liabilities	
Equity attributable to owners of parent	
Share capital	520
Retained earnings W5	256·32
Other components of equity W5	9·5
	785·82
Non-controlling interest W7	148·88
	934·7
Non-current liabilities	
Long-term borrowings	140
Deferred tax W10	39·4
Total non-current liabilities	179·4
Current liabilities	
Trade and other payables W6	217
Current tax payable	92
Total current liabilities	309
Total liabilities	488·4
Total equity and liabilities	1,423·1

Working 1

Message

	$m
Fair value of consideration for 80% interest	300
Fair value of non-controlling interest	86
	386
Amount of identifiable net assets acquired	(400)
Gain on bargain purchase	(14)

Essentially the entries would be:

	$m	$m
DR Net identifiable assets	400	
CR Cash		300
CR Gain on bargain purchase		14
CR Equity – non-controlling interest		86
	400	400

Working 2

Mixted

	$m
1 June 2008 (128 – 10)	118
Contingent consideration	12
Total consideration transferred	130
Fair value of equity interest held before business combination	15
Fair value of consideration	145
Fair value of non-controlling interest	53
	198
Identifiable net assets	(170)
Increase in value	(6)
Deferred tax (176 – 166) x 30%	3
Goodwill	25

Working 3

Clarity

The gain of 1 recorded within other equity should now be deemed realised once the shareholding has been increased to 25%. An adjustment is required to reclassify this gain.

DR	Other components of equity (9 – 8)	1
CR	Profit or Loss (Retained Earnings)	1

The amount included in the consolidated statement of financial position would be:

	$m
Cost ($9 million + $11 million)	20
Share of post acquisition profits ($10 million x 25%)	2·5
	22·5

(There is an alternative way of dealing with Clarity which is to reduce the value of the original investment to cost as it has been classified as available for sale.

DR	Other components of equity (9 – 8)	1
CR	Investment in associate	1

The amount included in the consolidated statement of financial position would be:

	$m
Cost ($8 million + $11 million)	19
Share of post acquisition profits ($6 million x 10% + $10 million x 25%)	3·1
	22·1

This would affect the statement of financial position.)

Working 4

Available for sale instrument

Date	Exchange rate	Value		Change in fair value
		Dinars m	$m	$m
1 June 2007	4·5	11	49·5	
31 May 2008	5·1	10	51	1·5
31 May 2009	4·8	7	33·6	(17·4)

The asset's fair value in the overseas currency has declined for successive periods. However, no impairment loss is recognised in the year ended 31 May 2008 as there is no loss in the reporting currency ($). The gain of $1·5 million would be recorded in equity. However, in the year to 31 May 2009 an impairment loss of $17·4 million will be recorded as follows:

		$m
DR	Other components of equity	1·5
DR	Profit or loss	15·9
CR	AFS investments	17·4

Working 5

Retained earnings

	$m
Bravado:	
Balance at 31 May 2009	240
Associate profits W3	2·5
AFS impairment W4	(15·9)
Increase in fair value of Clarity now realised	1
Write down of inventory W8	(18)
Increase in fair value of equity interest – Mixted (15 – 10)	5
Gain on bargain purchase	14
Post acquisition reserves: Message	11·2
Mixted	16·52
	256·32

	$m
Message:	
Post acquisition reserves (150 – 136) i.e. $14m	
Group reserves – 80%	11·2
NCI – 20%	2·8
	14

	$m
Mixted:	
Post acquisition reserves:	
at 31 May 2009 (80 – 55)	25
Less increase in depreciation	(2)
Add deferred tax movement	0·6
	23·6
Group reserves – 70%	16·52
NCI – 30%	7·08
	23·6

Bravado: other components of equity	$m
Balance at 31 May 2009	12
Investment in associate W3	(1)
Impairment loss – AFS W4	(1·5)
	9·5

Working 6

Current liabilities – trade payables	$m
Balance at 31 May 2009	
Bravado	115
Message	30
Mixted	60
	205
Contingent consideration	12
	217

Working 7

Non-controlling interest	$m
Message	86
Post acquisition reserves	2·8
	88·8
Mixted	53
Post acquisition reserves	7·08
	60·08
Total	148·88

Working 8

Inventories

HKAS2 'Inventories' states that estimates of net realisable value should take into account fluctuations in price occurring after the end of the period to the extent that it confirms conditions at the year end. The new model would have been developed over a period of time and, therefore, would have existed at the year end. The loss in value should be adjusted for. Additionally, although the selling price per stage can be determined, net realisable value (NRV) is based on the selling price of the finished product, and this should be used to calculate NRV.

	$
Selling price of units	1,450
Less selling costs	(10)
NRV	1,440
Less conversion costs	(500)
NRV at 1st stage	940

Write down	$m
200,000 units x (1,500 – 1,440)	12
100,000 units x (1,000 – 940)	6
	18

There will have to be an investigation of the difference between the total value of the above inventory and the amount in the financial statements.

Working 9

Property, plant and equipment

	$m	$m
Bravado	265	
Message	230	
Mixted	161	
		656
Increase in value of land – Message (400 – 220 – 136 – 4)		40
Increase in value of PPE – Mixted (176 – 100 – 55 – 7)		14
Less: increased depreciation (14 ÷ 7)		(2)
		708

Working 10

Available for sale financial assets	$m	$m
Bravado	51	
Message	6	
Mixted	5	
		62
Less: impairment loss		(17·4)
		44·6

Inventories	$m	$m
Bravado	135	
Message	55	
Mixted	73	
		263
Less: write down to NRV		(18)
		245

Deferred tax	$m	$m
Bravado	25	
Message	9	
Mixted	3	
		37
Arising on acquisition		3
Movement to year end		(0·6)
		39·4

Working 11

Trade receivables

	$m	$m
Bravado	91	
Message	45	
Mixted	32	
		168

(b) **Message:**

Gain on bargain purchase if proportionate interest method is used.

	$m
Consideration	300
Identifiable net assets	(400)
Non-controlling interest (20% x 400)	80
Gain on bargain purchase	(20)

	$m
Mixted:	
Purchase consideration	145
Identifiable net assets less deferred tax	
(170 initial fair value + 6 additional fair value – 3 deferred tax)	(173)
Non-controlling interest (30% x 173)	51·9
Goodwill	23·9

Thus in the case of Mixted, the proportionate interest method results in lower net assets in the statement of financial position where goodwill is created with the result that impairment of goodwill may be less. Additionally in the case of Message, it results in a higher gain on the bargain purchase which increases the reported income.

(c) Showing a loan as cash and cash equivalents is misleading. The Framework says that financial statements should have certain characteristics:

(a) understandability
(b) relevance
(c) reliability
(d) comparability

These concepts would preclude the showing of directors' loans in cash. Such information needs separate disclosure as it is relevant to users as it shows the nature of the practices carried out by the company. Reliability requires information to be free from bias and faithfully represent transactions. Comparability is not possible if transactions are not correctly classified. Directors are responsible for the statutory financial statements and if they believe that they are not complying with HKFRS, they should take all steps to ensure that the error or irregularity is rectified. Every director will be deemed to have knowledge of the content of the financial statements. Directors have a responsibility to act honestly and ethically and not be motivated by personal interest and gain. If the ethical conduct of the directors is questionable then other areas of the financial statements may need scrutiny. A loan of this nature could create a conflict of interest as the directors' personal interests may interfere or conflict with those of the company's. The accurate and full recording of business activities is essential to fulfil the financial and legal obligations of a director as is the efficient use of corporate assets. The loan to a director conflicts with the latter principle.

2 **(a)** **Discussion of fair value and its relevance**

The fair value of an asset is the amount at which that asset could be bought or sold in a current transaction between willing parties, other than in a liquidation. The fair value of a liability is the amount at which that liability could be incurred or settled in a current transaction between willing parties, other than in a liquidation. If available, a quoted market price in an active market is the best evidence of fair value and should be used as the basis for the measurement. If a quoted market price is not available, preparers should make an estimate of fair value using the best information available in the circumstances. This may include discounting future cash flows or using pricing models such as Black-Scholes. However these methods all use an element of estimation which in itself can create discrepancies in the values that result. In an efficient market these differences should be immaterial.

The standard setters have concluded that fair value is the most relevant measure for most financial instruments. Fair value measurements provide more transparency than historical cost based measurements. Reliability is as important as relevance because relevant information that is not reliable is of no use to an investor. Fair value measurements should be reliable and computed in a manner that is faithful to the underlying economics of the transaction. Measuring financial instruments at fair value should not necessarily mean abandoning historical cost information.

However, market conditions will affect fair value measurements. In many circumstances, quoted market prices are unavailable. As a result, difficulties occur when making estimates of fair value. It is difficult to apply fair value measures in

illiquid markets and to decide how and when models should be used for fair valuation. Fair value information can provide a value at the point in time that it is measured but its relevance will depend on the volatility of the market inputs and whether the instruments are actively traded or are held for the long term. Fair value provides an important indicator of risk profile and exposure but to fully understand this and to put it into context, the entity must disclose sufficient information.

(b) (i) **Convertible bond**

Some compound instruments have both a liability and an equity component from the issuer's perspective. In this case, HKAS32 'Financial Instruments: Presentation' requires that the component parts be accounted for and presented separately according to their substance based on the definitions of liabilities and equity. The split is made at issuance and not revised for subsequent changes in market interest rates, share prices, or other events that changes the likelihood that the conversion option will be exercised. (HKAS32.28)

A convertible bond contains two components. One is a financial liability, namely the issuer's contractual obligation to pay cash in the form of interest or capital, and the other is an equity instrument, which is the holder's option to convert into shares. When the initial carrying amount of a compound financial instrument is required to be allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. (HKAS32.31)

In the case of the bond, the liability element will be determined by discounting the future stream of cash flows which will be the interest to be paid and the final capital balance assuming no conversion. The discount rate used will be 9% which is the market rate for similar bonds without the conversion right. The difference between cash received and the liability component is the value of the option.

	$000
Present value of interest at end of:	
Year 1 (31 May 2007) ($100m x 6%) ÷ 1·09	5,505
Year 2 (31 May 2008) ($100m x 6%) ÷ $1·09^2$	5,050
Year 3 (31 May 2009) ($100m + ($100m x 6%))÷ $1·09^3$	81,852
Total liability component	92,407
Total equity element	7,593
Proceeds of issue	100,000

The issue cost will have to be allocated between the liability and equity components in proportion to the above proceeds.

	$000 Liability	$000 Equity	$000 Total
Proceeds	92,407	7,593	100,000
Issue cost	(924)	(76)	(1,000)
	91,483	7,517	99,000

The credit to equity of $7,517 would not be re-measured. The liability component of $91,483 would be measured at amortised cost using the effective interest rate of 9·38%, as this spreads the issue costs over the term of the bond. The interest payments will reduce the liability in getting to the year end. The initial entries would have been:

	$000		$000
Dr Cash	100,000	Cr Cash	1,000
Cr Liability	92,407	Dr Liability	924
Cr Equity	7,593	Dr Equity	76

The liability component balance on 31 May 2009 becomes $100,000 as a result of the effective interest rate of 9·38% being applied and cashflows at 6% based on nominal value.

B/f	Effective Interest 9·38%	Cashflow 6%	C/f
91,483	8,581	6,000	94,064
94,064	8,823	6,000	96,887
96,887	9,088	6,000	~100,000

On conversion of the bond on 31 May 2009, Aron would issue 25 million ordinary shares of $1 and the original equity component together with the balance on the liability will become the consideration.

	$000
Share capital – 25 million at $1	25,000
Share premium	82,517
Equity and liability components (100,000 + 7,593 – 76)	107,517

(ii) **Shares in Smart**

In this situation Aron has to determine if the transfer of shares in Smart qualifies for derecognition. The criteria are firstly to determine that the asset has been transferred, and then to determine whether or not the entity has transferred

substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded. (HKAS39.20)

In this case the transfer of shares qualifies for derecognition as Aron no longer retains any risks and rewards of ownership. In addition Aron obtains a new financial asset which is the shares in Given which should be recognised at fair value. The transaction will be accounted for as follows:

	$m
Proceeds	5·5
Carrying amount of shares in Smart	5
Gain on recognition	0·5
Gain in equity reclassified	0·4
Gain to profit/loss	0·9

The gain on disposal will be $900,000. The accounting entries would be:

	$m		$m
Dr Shares in Given	5·5	Cr Gain on sale	0·4
Cr Shares in Smart	5	Dr Equity	0·4
Cr Gain on sale	0·5		
Gain on sale		Transfer of accrued gain in equity	

(iii) Foreign Subsidiary

In this situation, HKAS39 will apply to the debt instrument in the foreign subsidiary's financial statements and HKAS21, 'The Effects of Changes in Foreign Exchange Rates', will apply in translating the financial statements of the subsidiary. Under HKAS21, all exchange differences resulting from translation are recognised in equity until disposal of the subsidiary. This includes exchange differences on financial instruments carried at fair value through profit or loss and financial assets classified as available-for-sale.

As the debt instrument is held for trading it will be carried at fair value through profit or loss in Gao's financial statements. Thus at 31 May 2009, there will be a fair value gain of 2 million zloti which will be credited to the income statement of Gao. In the consolidated financial statements, the carrying value of the debt at 1 June 2008 would have been $3·3 million (10 million zloti ÷ 3). At the year end this carrying value will have increased to $6 million (12 million zloti ÷ 2). Aron will translate the income statement of Gao using the average rate of 2·5 zloti to the dollar. Although the fair value of the debt instrument has increased by $2·7 million, Aron will only recognise 2 million zloti ÷ 2·5, i.e. $800,000 of this in the consolidated income statement with the remaining increase in value of ($2·7 – $0·8) million, i.e. $1,900,000 being classified as equity until the disposal of the foreign subsidiary.

	$m
Opening balance at 1 December 2008	3·3
Increase in year	2·7
Closing balance at 30 November 2009	6·0
Dr Debt instrument	2·7
Cr Consolidated income statement	0·8
Cr Equity	1·9

(iii) Interest Free Loans

When a financial asset is recognised initially, HKAS39 requires it to be measured at fair value, plus transaction costs in certain situations. Normally the fair value is the fair value of the consideration given. However, the fair value of an interest free loan may not necessarily be its face amount. The instrument's fair value may be evidenced by comparison with other market transactions in the same instrument. In this case, the fair value may be estimated as the discounted present value of future receipts using the market interest rate. The difference between the fair value of the loan and the face value of the loan will be treated as employee remuneration under HKAS19, 'Employee Benefits'.

	$m
Fair value of loan at 1 June 2008 ($10/(1{\cdot}06^2)$)	8·9
Employee compensation	1·1
	10

The employee compensation would be charged to the income statement over the two-year period. As the company wishes to classify the asset as loans and receivables, it will be measured at 31 May 2009, at amortised cost using the effective interest method. In this case the effective interest rate will be 6% and the value of the loan in the statement of financial position will be ($8·9 million x 1·06) i.e. $9·43 million. Interest of $0·53 million will be credited to the income statement.

At 1 June 2008

	$m
Dr Loan	8·9
Dr Employee compensation	1·1
Cr Cash	10

At 31 May 2009

Dr Loan	0·53
Cr Income statement – interest	0·53

3 Supply arrangements

(i) Vehiclex

A transaction may contain separately identifiable components that should be accounted for separately. HKAS18 'Revenue' says that it is necessary to apply the recognition criteria to each separately identifiable component of a single transaction in order to reflect the substance of the transaction. In assessing the substance, the transaction should be viewed from the customer's perspective and not the seller. If the customer views the purchase as one product, then it is likely that the recognition criteria should be applied to the transaction as a whole. If there are a number of elements to the transaction, then the revenue recognition criteria should be applied to each element separately. In this case there is no contract to sell the machinery to Vehiclex and thus no revenue can be recognised in respect of the machinery. The machinery is for the use of Carpart and the contract is not a construction contract under HKAS11 'Construction Contracts'. The machinery is accounted for under HKAS16 'Property, Plant and Equipment' and depreciated assuming that the future economic benefits of the machinery will flow to Carpart and the cost can be measured reliably. Carpart should conduct impairment reviews to ensure the carrying amount is not in excess of recoverable amount whenever there is deemed to be an indication of impairment. Seat orders not covering the minimum required would be an example of an impairment indicator. The impairment review of the machine would most probably need to be conducted with the machinery forming part of a cash generating unit. The contract to manufacture seats is not a service or construction contract but is a contract for the production of goods. The contract is a contract to sell goods and HKAS18 is applicable with revenue recognised on sale.

(ii) Autoseat

Companies often enter into agreements that do not take the legal form of a lease but still convey the right to use an asset in return for payment. HK(IFRIC)-Int 4 'Determining whether an arrangement contains a lease' provides guidance on when such arrangements are leases. If it is determined that the arrangement constitutes a lease, then it is accounted for under HKAS17 'Leases'. HK(IFRIC)-Int 4 sets out when the assessment should be made and how to deal with the payments. Under HK(IFRIC)-Int 4, a lease is based on the substance of the arrangement which means assessing if:

(i) fulfilment of the contract is dependent upon the use of a specified asset; and
(ii) the contract conveys the right to use the asset. This means by operating the asset, controlling physical access, or if there is only a remote possibility that parties other than the purchaser will take more than a significant amount of the assets' output and the price the purchaser will pay is neither fixed per unit of output nor equal to the current market price.

In this case it seems that the contract contains a lease for the following reasons:

(i) the completion of the contract depends upon the construction and use of a specific asset which is the specialised machinery which is dedicated to the production of the seats and cannot be used for other production. All of the output is to be sold to Autoseat who can inspect the seats and reject defective seats before delivery;
(ii) the contract allows Autoseat the right to use the asset because it controls the underlying use as it is remote that any other party will receive any more than an insignificant amount of its production. The only customer is Autoseat who sets the levels of production and has a purchase option at any time;
(iii) The price of the production is not fixed as it is a 'take or pay' contract as Autoseat is committed to fully repay the cost of the machinery, nor is it equal to the current market price because the supply is not marked to market during the contract;
(iv) The payments for the lease are separable from any other elements in the contract (HK(IFRIC)-Int 4) as Carpart will recover the cost of the machinery through a fixed price per seat over the life of the contract.

The contract contains a finance lease in the financial statements of Carseat because of the specialised nature of the machinery and because the contract is for the life of the asset (three years). The payments under the contract will be separated between the lease element and the revenue for the sale of the car seats. Carpart will recognise a lease receivable equal to the net present value of the minimum lease payments. Carpart does not normally sell machinery nor recognises revenue on the sale of machinery and, therefore, no gain or loss should be recognised on recognition and the initial carrying amount of the receivable will equal the production cost of the machinery (HKAS17, 43). Lease payments will be split into interest income and receipt of the lease receivables.

(iii) Car Sales

HKAS18 states that a sale and repurchase agreement for a non-financial asset must be analysed to determine if the seller has transferred the risks and rewards of ownership to the buyer. If this has occurred then revenue is recognised. Where the seller has retained the risks and rewards of ownership, the transaction is a financial arrangement even if the legal title has been transferred.

In the case of vehicles sold and repurchased at the end of the contract period, Carpart should recognise revenue on the sale of the vehicle. The residual risk that remains with Carpart is not significant at 20% of the sale price as this is thought to be significantly less than the market price. The agreed repurchase period also covers most of the vehicle's economic life. The car has to be maintained and serviced by the purchaser and must be returned in good condition. Thus the transfer of the significant risks and rewards of ownership to the buyer would appear to have taken place.

In the case of the sale with an option to repurchase, Carpart has not transferred the significant risks and rewards of ownership at the date of the transaction. The repurchase price is significant and the agreed repurchase period is less than substantially all of the economic life of the vehicle. The repurchase price is above the fair value of the vehicle and thus the risks of ownership have not been transferred. Also the company feels that the option will be exercised. The transaction is accounted for as an operating lease under HKAS17. The cars will be accounted for as operating leases until the option expires. The vehicles will be taken out of the inventory and debited to 'assets under operating lease' and depreciated over two years taking into account the estimated residual value. The cash received will be split between rentals received in advance (30%) and long-term liabilities (70%) which will be discounted. The rental income will be recognised in profit or loss over the two-year period.

Demonstration vehicles

The demonstration vehicles should be taken out of inventory and capitalised as property, plant and equipment (PPE) at cost. They meet the recognition criteria as they are held for demonstration purposes and are expected to be used in more than one accounting period. They should be depreciated whilst being used as demonstration vehicles and when they are to be sold they are reclassified from PPE to inventory and depreciation ceased.

4 (a) (i) Accounting for post-employment benefits is an important financial reporting issue. It has been suggested that many users of financial statements do not fully understand the information that entities provide about post-employment benefits. Both users and preparers of financial statements have criticised the accounting requirements for failing to provide high quality, transparent information about post-employment benefit promises.

Delays in the recognition of gains and losses give rise to misleading figures in the statement of financial position. Also, multiple options for recognising gains and losses and lack of clarity in the definitions can lead to poor comparability. HKAS 19 permits entities to recognise some changes in the value of plan assets and in the defined benefit obligation in periods after the period in which they occur. Specifically,

- It permits entities to leave unrecognised actuarial gains and losses within a 'corridor' (the greater of 10% of plan assets and 10% of plan liabilities) and to defer recognition of actuarial gains and losses that exceed the corridor. Entities can recognise the gains and losses that exceed the corridor over the service lives of the employees. HKAS 19 also permits entities to adopt any systematic method that results in recognition of actuarial gains and losses faster than the minimum requirements.
- In addition, it permits immediate recognition of all gains and losses, either in
  - profit or loss or
  - in other comprehensive income.

The deferred recognition model in HKAS 19 treats the recognition of changes in defined benefit obligations and in plan assets differently from changes in other assets and liabilities. The main criticisms of the deferred recognition model are:

- An employer with a defined benefit plan is not required to recognise economic changes in the cost of providing post-employment benefits (the changes in plan assets and benefit obligations) as those changes take place.
- An entity may recognise an asset when a plan is in deficit or a liability may be recognised when a plan is in surplus.
- It relegates important information about post-retirement plans to the notes to the financial statements
- The resulting accounting has a level of complexity that makes it difficult for many users of financial statements to understand and
- adds to the cost of applying HKAS 19 by requiring entities to keep complex records.

Advantages of immediate recognition
Immediate recognition would be consistent with the Framework and other HKFRSs. The Framework requires that 'the effects of transactions and other events are recognised when they occur … and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate'. Immediate recognition of actuarial gains and losses is consistent with HKAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'. HKAS 8 requires the effect of changes in accounting estimates to be included in the period of the change to the extent that the change gives rise to changes in assets and liabilities. HKAS 37 requires changes in liabilities, including changes in long-term liabilities (such as asset retirement obligations), to be recognised in the period they occur.

Immediate recognition also has the following advantages:

- It represents faithfully the entity's financial position. An entity will recognise an asset only when a plan is in surplus and a liability only when a plan has a deficit.
- It results in amounts in the statements of financial position and comprehensive income that are transparent and easy to understand.
- The approach generates income and expense items that provide information about changes in the post-employment benefit obligation and plan assets in that period.
- It improves comparability across entities by eliminating the options currently allowed by HKAS 19.

(ii) HKAS 19 states that the rate to be used to discount pension obligations should be determined by reference to market yields at the balance sheet date on high quality corporate bonds of equivalent currency and term to benefit obligations. The discount rate should reflect the time value of money, based on the expected timing of the benefit payments. The discount rate does not reflect investment risk or actuarial risk as other actuarial assumptions deal with these items. HKAS 19 is not specific on what it considers to be a high quality bond and therefore this can lead to variation in the discount rates used. Also some countries may not have a market in high quality corporate bonds, in which case the market yields on government bonds of equivalent currency and term should be used. The result is that there is a measure of subjectivity in the setting of discount rates which could lead to management of earnings and the reduction of liabilities.

The return on plan assets is defined as interest, dividends and other revenue derived from plan assets, together with realised and unrealised gains or losses on plan assets, less any costs of administering the plan less any tax payable by the plan itself. The amount recognised in the financial statements under HKAS 19 is the expected return on assets, and the difference between the expected return and actual return in the period is an actuarial gain or loss. The expected return is based on market expectations at the beginning of the period for returns over the entire life of the related obligation. The standard also requires an adjustment to be made to the expected return for changes in the assets throughout the year. This return is a very subjective assumption and an increase in the return can create income at the expense of actuarial losses which may not be recognised because both companies use the 'corridor approach'.

(b) In the case of Smith and Brown, the companies have experienced dramatically different investment performance in the year.

The expected and actual return on plan assets was:

	Smith ($m)	Brown ($)
Fair value of plan assets at 1 May 2008	200	200
Contribution	70	70
Benefits paid	(26)	(26)
Expected return (200 x 7% + (70 – 26) x 6/12 x 7%)	15·5	15·5
	259·5	259·5
Actuarial gain/(loss)	(40·5)	16·5
Fair value of plan assets at 30 April 2009	219	276
Unrecognised actuarial gain/(loss) at 1 May 2008	6	6
Actuarial gain/(loss) in the year	(40·5)	16·5
Unrecognised actuarial gain/(loss)	(34·5)	22·5

The difference between the expected return and the actual return represents an actuarial loss in the case of Smith of $40·5 million (being expected gain $15·5 becoming an actual loss $25) and an actuarial gain of $16·5 million in the case of Brown (being expected gain $15·5 becoming an actual gain of $32). Therefore the cumulative net unrecognised gains and losses at the year ended 30 April 2009 of Smith and Brown are $34·5 million loss and $22·5 million gain respectively.

In the year to 30 April 2009, there would not be any recognition of any of the above gains/losses as the corridor approach is based upon opening scheme assets, liabilities and gains/losses. The opening unrecognised gain is $6 million which is less than 10% of the plan assets ($20 million) which would be used for these purposes as it is greater than the obligation at May 2008.

Despite very different performance, the amount shown as expected return on plan assets in the statement of comprehensive income would be identical for both companies and the actuarial gains and losses would not be recognised in the current period. The investment performance of Smith has been poor and Brown has been good. However, this is not reflected in profit or loss. It can only be deduced from the disclosure of the actuarial gains and losses. It is the 'real' return on plan assets which is important, and not the expected return.Thus the use of the expected return on the plan assets can create comparison issues for the potential investor especially if the complexities of HKAS 19 are not fully understood.

				Marks
1	**(a)**	Message		5
		Mixted		6
		Clarity		4
		AFS instrument		3
		Retained earnings		3
		Post acquisition reserves		2
		Other components of equity		2
		Current liabilities		1
		NCI		2
		Inventories		2
		PPE		2
		AFS		1
		Deferred tax		1
		Trade receivables		1
				35
	(b)	Message		3
		Mixted		3
		Explanation		2
				8
	(c)	Subjective		7
			AVAILABLE	50

					Marks
2	**(a)**	Fair value – subjective			4
	(b)	Convertible bond:	explanation		2
			calculation		4
		Shares in Smart:	explanation		2
			calculation		2
		Foreign subsidiary:	explanation of principles		2
			accounting treatment		3
		Interest free loan:	explanation of principles		2
			accounting treatment		2
		Quality of explanations			2
					21
				AVAILABLE	25

					Marks
3	Vehiclex	–	HKAS18		2
			HKAS11		1
			HKAS16		1
	Autoseat	–	HK(IFRIC)-Int 4		3
			Discussion		3
			Finance lease		3
	Sale of vehicles	–	HKAS18		3
			Repurchase four years		2
			Repurchase two years		3
			Demonstration		2
	Professional marks				2
				AVAILABLE	25

			Marks
4	**(a)**	Subjective	17
		Professional marks	2
			19
	(b)	Calculation	3
		Discussion	3
			6
		AVAILABLE	25