Answers

1 (a) Bravado plc

Consolidated Balance Sheet at 31 May 2009

	£m
Fixed assets:	
Tangible assets W9	703
Positive goodwill W2	12·6
Negative goodwill W2	(17·1)
Investment in associate W3	18
Available for sale financial assets W10	44·6
	761·1
Current assets:	
Stock and work in progress W10	245
Trade debtors W11	168
Loans to directors	1
Cash at bank and in hand	209
	623
Creditors: amounts falling due within one year	
Trade creditors W6	217
Tax payable	92
	309
Net current assets	314
Total assets less current liabilities	1,075·1
Creditors: amounts falling due after more than one year	
Long-term borrowings	140
Deferred tax W10	39·4
	179·4
Net assets	895·7
Share capital	520
Other reserves W5	9·3
Profit and loss reserve W5	224·62
Total shareholders funds	753·92
Minority interest W7	141·78
Capital employed	895·7

Working 1

Message

Message:
Gain on bargain purchase

	£m
Identifiable net assets	400
Minority interest (20% x 400)	(80)
Consideration	(300)
Gain on bargain purchase (negative goodwill)	20

Amortisation

Negative goodwill (£20m divided by 7 years)	2·9

Negative goodwill up to the fair values of the non-monetary assets acquired should be amortised to the profit and loss account in the periods in which the non-monetary assets are recovered. i.e. seven years.

Working 2

Mixted

Goodwill

	£m
1 June 2008 (133 – 15)	118
Contingent consideration	12
Total consideration transferred	130
Cost of equity interest held before business combination	10
	140
Identifiable net assets	170
Increase in value	6
Deferred tax (166 – 156) x 30%	(3)
	173
Net assets attributable to Bravado (70%)	121·1
Goodwill (140 – 121·1)	18·9
Amortisation (divided by 3 years)	6·3

Goodwill in the balance sheet should disclose positive and negative goodwill separately (FRS10 para 48), hence Message negative goodwill of £17·1m and Mixted positive goodwill of £12·6m should not be netted off.
Minority interest (30% x 176 – 3) i.e. £51·9m

Working 3

Clarity

The gain of 1 recorded within other equity needs to be removed thereby reducing 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 balance sheet would be:

	£m
Cost (£8 million + £11 million)	19
Share of post acquisition profits (£10 million x 25%)	2·5
	21·5

The investment in associate would then need to be impaired by £3·5 million to reduce the investment to the recoverable amount of £18 million. The loss of £3·5 million being taken to profit and loss.

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/loss account	15·9
CR	AFS investments	17·4

Working 5

Profit and loss reserve

		£m
Bravado:		
Balance at 31 May 2009		240
Associate profits		2·5
Impairment loss		(3·5)
AFS impairment		(15·9)
Write down of stock		(18)
Negative goodwill – amortisation		2·9
Goodwill amortisation		(6·3)
Share based payment		(4·8)
Post acquisition reserves:	Message	11·2
	Mixted	16·52
		224·62

	£m
Message:	
Post acquisition reserves (150 – 136) i.e. £14m	
Group reserves – 80%	11·2
MI – 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
MI – 30%	7·08
	23·6

Bravado: other reserves	£m
Balance at 31 May 2009	12
Investment in associate W3	(1)
Impairment loss – AFS. W4	(1·5)
Share based payment	4·8
Available for sale profit on investment in Mixted	(5)
	9·3

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

Minority interest	£m
Message	80
Post acquisition reserves	2·8
	82·8
Mixted	51·9
Post acquisition reserves	7·08
	58·98
Total	141·78

Working 8

Stock

SSAP 9 states that events occurring between the balance sheet and the date of completion of the financial statements need to be considered in arriving at the net realisable value. 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 stock and the amount in the financial statements.

Working 9

Tangible fixed assets

	£m	£m
Bravado	260	
Message	230	
Mixted	161	
		651
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)
		703

Working 10

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

Stock	£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 debtors

	£m	£m
Bravado	91	
Message	45	
Mixted	32	
		168

Working 12

Share options
Year to 31 May 2008
Expense for year is 1,000 x 2,000 x £6 x 90% x 1/3 = £3·6m

Expense to 31 May 2009
Expense for year is 1,000 x 2,000 x 93% x ((£6 x 2/3) + (1 x $^1/_2$)) i.e. £8·4
Less expense for year to 31 May 2008 (£3·6m) i.e. £4·8m

Where a modification increases the fair value of the equity instruments granted, an entity should include the incremental value in the measurement of the amount recognised for services.

(b) The Companies Act and FRS 2 'Accounting for subsidiary undertakings' require consolidation of undertakings over which the company has power to control. The effective date is the date on which control passes to the new parent company. FRS 2 requires this date to be the date of acquisition. The date will be when the company has the ability to direct the financial and operating policies of the other undertaking with a view to gaining economic benefits. The gaining of economic benefits can be widely interpreted to include the receipt of current or future profits, the prevention of a key supplier going out of business, the reduction of the losses of the acquiring group or as in the case of Bravado, the prevention of another competitor from acquiring the company (Fusion). FRS 2 says that the date that control passes is a matter of fact and cannot be artificially altered. The additional factors that should be taken into account are when the acquirer starts to direct the operating and financial policies of the acquired undertaking and the date that the consideration is paid. Where there is an offer of shares as in this case, then the date that control is transferred is the date that the offer becomes unconditional. That is the date that there is a sufficient number of acceptances received to enable Bravado to exercise control over Fusion. The negotiations to purchase a subsidiary may take a considerable period of time. If the effective date of acquisition is after the year end of Bravado but before the consolidated financial statements are approved, the transaction should be treated as a non-adjusting post balance sheet event in accordance with FRS 21 'Events after the balance sheet date'. If Bravado wishes to show the impact of the acquisition of Fusion then additional information should be shown in the notes to the financial statements.

(c) Showing a loan as cash is misleading. The Statement of Principles 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 FRS, 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. In the UK, loans to directors must be approved by the shareholders. Directors have a responsibility to act honestly and ethically and not be motivated by personal interest and gain. 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 ASB has 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) Some compound instruments have both a liability and an equity component from the issuer's perspective. In this case, FRS 25 'Financial Instruments: Disclosure and 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 change the likelihood that the conversion option will be exercised.

(i) Convertible Bond

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.

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%) ÷ $1{\cdot}09^2$	5,050
Year 3 (31 May 2009) (£100m + (£100m x 6%)) ÷ $1{\cdot}09^3$	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. (FRS 26)

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, FRS 26 will apply to the debt instrument in the foreign subsidiary's financial statements and FRS 23, 'The Effects of Changes in Foreign Exchange Rates', will apply in translating the financial statements of the subsidiary. Under FRS 23, 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 profit and loss account 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 profit and loss account 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 profit and loss account 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 profit and loss account	0·8
Cr Equity	1·9

(iv) Interest Free Loans

When a financial asset is recognised initially, FRS 26 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 FRS 17 'Retirement 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 profit and loss account 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 Profit and loss account – interest		0·53

3 Supply arrangements

(i) Vehiclex

A transaction may contain separately identifiable components that should be accounted for separately. FRS 5 Application note G states that a contractual arrangement with two or more components should be accounted for as two or more separate transactions only where the commercial substance is that the individual components operate independently of one another. Components operate independently where each element represents a separable good or service that the seller can provide to customers on a stand alone basis or as an optional extra. 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 SSAP 9 'Stock and Long-term contracts' The machinery is accounted for under FRS 15 'Tangible Fixed Assets' 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 impairments 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 be conducted with the machinery forming part of an income 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 FRS5 Application note G 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 of payment. FRS 5 'Reporting the substance of transactions' helps determine the nature of the transaction by ensuring that the commercial effect of the transaction is looked at. If it is determined that the arrangement constitutes a lease, then it is accounted for under SSAP 21 'Accounting for Leases and Hire Purchase Contracts'. SSAP 21 includes in the definition of a lease any arrangement not described as a lease, in which one party retains ownership but conveys the right to use an asset for an agreed period of time in return for specific rentals. Assessment should be made based on the substance of the arrangement which means assessing if fulfilment of the contract is dependent upon the use of a specified asset and the contract conveys the right to use the asset. 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. 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; Autoseat is committed to fully repay the cost of the machinery. The payments for the lease are separable from any other elements in the contract as Carpart will recover the cost of the machinery through a fixed price per seat over the life of the contract.

The contract therefore contains a finance lease 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. Lease payments will be split into interest income and receipt of the lease receivables.

(iii) Car Sales

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 their expected life, Carpart should recognise revenue on the sale of the vehicle. The residual risk that remains with Carpart is not significant at 25% of the sale price as this is thought to be substantially less than the market price. The agreed repurchase period also covers all of the vehicles 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 has 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 SSAP 21. 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'. 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 the profit and loss account over the two-year period.

Demonstration vehicles

The demonstration vehicles should be taken out of inventory and capitalised as tangible fixed assets at cost. They meet the recognition criteria as they are held for administration 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 fixed assets to stock and depreciation ceased.

4 (a) (i) Pension obligations arise under employment contracts in exchange for services. Liabilities arise when there is a present obligation to transfer economic benefits (Statement of Principles). Scheme liabilities can be defined as 'the liabilities of a defined benefit scheme for outgoings due after the valuation date'. It is at the time that the services are provided that a liability arises and reflect the benefits that the employer is committed to provide up to the valuation date. The components of the scheme liabilities reflect the characteristics of a present obligation in FRS 12 'Provisions, contingencies and commitments'. The liability is subject to a number of uncertainties including those relating to future prices and demographic factors such as mortality rates. These factors are relevant to the measurement of the liability, not whether it exists. The liability includes increases that the entity by legal or constructive obligation is presently committed to pay. Where the entity has discretion over the amount of the future benefit, it should not be included in the liability. The liability should also not reflect future possible changes to the entity's or the pension scheme's financial position but should include changes to the pension scheme that have vested. The general principle of FRS 17 'Retirement Benefits' is that the obligation arises over the period of the employees service and represents a long term accrual of a portion of those total benefits.

A gross presentation would appropriately reflect the economic substance and be consistent with accounting principles applied elsewhere in the standards. There is no conceptual reason why FRS should provide an exemption from the consolidation of pension plans particularly where the employer has control over the plan assets and liabilities. The presentation of the assets and liabilities should reflect the substance of the relationship between the employer and the scheme, particularly where the employer has the decision-making powers of the plan and can direct the trustees of the plan or can determine the investment, funding or benefit policy. However, it could be argued that the user of financial statements is interested in the 'net position/liability' and the 'gross' position can easily be obtained from the notes to the financial statements.

(ii) FRS 17 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 long dated AA rated corporate bonds. Yields on AA corporate bonds have steadily declined and equity markets have become increasingly volatile, plunging many schemes into deficit. Recently schemes have unexpectedly benefited from the current market turmoil. The discount rate used to discount liabilities is now so high that it more than compensates for the problems of falling interest rates, rising inflation and volatile equity markets. 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. FRS17 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. 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 ASB's belief is that a risk free rate is the most accurate measure of the 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 FRS 17 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.

(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 (30 April 2009)	219	276
Less fair value of plan assets (1 May 2008)	(200)	(200)
Less contributions received	(70)	(70)
add benefits paid	26	26
Actual return on plan assets (loss)	(25)	32

The expected return on plan assets was

Return on £200 million for one year at 7%	14
Return on net contributions at 3·5% approx for six months ((70 – 26) at 3·5%)	1·5
Expected return on plan assets – 2009	15·5

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).

Despite very different performance, the amount shown as expected return on plan assets in the profit and loss account would be identical for both companies and the actuarial gains and losses would be recognised in the current period in the STRGL. The investment performance of Smith has been poor and Brown has been good. However, this is not reflected in the profit and loss account. 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 FRS 17 are not fully understood.

				Marks
1	**(a)**	Message		4
		Mixted		5
		Clarity		3
		AFS instrument		3
		Profit and loss reserve		3
		Post acquisition reserves		2
		Other components of equity		2
		Current liabilities		1
		MI		2
		Stock		2
		Tangible assets		2
		AFS		1
		Deferred tax		1
		Share based payment		3
		Trade debtors		1
				35
	(b)	Subjective		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	–	FRS 5		2
			FRS 15		1
			SSAP 9		1
	Autoseat	–	Discussion		6
			Finance lease		3
	Sale of vehicles	–	Risks and rewards		3
			Repurchase four years		2
			Repurchase two years		3
			Demonstration		2
	Professional marks				2
				AVAILABLE	25

			Marks
4	**(a)**	Obligation – subjective	7
		Consolidation – subjective	4
		Discount/return on assets – subjective	6
		Quality of discussion	2
			19
	(b)	Calculation and discussion	6
		AVAILABLE	25