(W11) **Defined Benefit Pension scheme.**

The $11 million paid is not the expense rather it creates a pension fund asset, The expense to be charged to profit – and hence retained earnings – is the current service cost of $9 million, thus a net adjustment of $2 million being added back to retained earnings is appropriate. The deficit under the pension scheme represents a non current liability that had not being previously recognised. There is no actuarial gain or loss in respect of the pension fund assets but as the scheme has a deficit of $3 million – when one expected a surplus of $2 million ($11 million less $9 million) then a actuarial loss has arisen of $ 5 million. This creates the negative other components of equity.

Dr Other components of equity – actuarial loss	$5 million
Cr Retained earnings – correction	$2 million
Cr Noncurrent liabilities – deficit	$3 million

(b) Whilst each of the three transactions may be considered to be not material, based upon the limited information available, all three transactions have an impact upon the reported performance and position of the group at 31 May 2011.

√0.5 IAS 21 requires that unsettled monetary items are retranslated at the reporting date using the exchange rate at that date. This will result in an exchange gain or loss on retranslations which is taken to income for the year ended 31 May 2011 as follows:

√1 At initial recognition of the Euro-denominated payable, it would be stated at (Euro 3,000 / 1.6) $1,875. At the reporting date, using the exchange rate at that date, the payable would be restated to (Euro 3,000 / 1.5) $2,000. There is an exchange loss of $125 as the dollar value of the payable is greater than initially recorded and this loss should be taken to income for the year.

√0.5 The subsequent settlement of the liability after the reporting date is not relevant for the financial statements for the year ended 31 May 2011; it is a non-adjusting event per IAS 10. The dollar cost of (Euro 3,000/1.7) of $1,765, giving rise to an exchange gain of $235 on settlement is accounted for in the financial statements to 31 May 2012.

√1 IAS 23 requires that borrowing costs are capitalised if they are incurred during the construction or purchase of a non-current asset. If they have been written off as finance costs during the year, the consequence is that the profit or loss for the year is understated √1 by $10,000, and that the carrying value of non-current assets is understated by the same amount.

There is also likely to be incorrect analysis within the statement of cash flows as the finance costs paid should be classified as interest paid, rather than as additions to non-current assets.

The treatment of lease payments inappropriately gives rise to several misstatements as follows:

√0.5 • Operating lease rental charges are overstated, leading to a reduction in the reported profit of the year. Finance lease assets have been omitted from the statement of financial position, which will understate the carrying value of assets. There will also √0.5 be omission of depreciation charges on the finance lease assets which should be charged to income for the year. Items in the statement of cash flows are likely to be misstated as the depreciated charge added back within operating activates will be wrong.