5 Pingway issued a $10 million 3% convertible loan note at par on 1 April 2007 with interest payable annually in arrears. Three years later, on 31 March 2010, the loan note is convertible into equity shares on the basis of $100 of loan note for 25 equity shares or it may be redeemed at par in cash at the option of the loan note holder. One of the company's financial assistants observed that the use of a convertible loan note was preferable to a non-convertible loan note as the latter would have required an interest rate of 8% in order to make it attractive to investors. The assistant has also commented that the use of a convertible loan note will improve the profit as a result of lower interest costs and, as it is likely that the loan note holders will choose the equity option, the loan note can be classified as equity which will improve the company's high gearing position.

The present value of $1 receivable at the end of the year, based on discount rates of 3% and 8% can be taken as:

	3%	**8%**
	$	**$**
End of year 1	0·97	0·93
2	0·94	0·86
3	0·92	0·79

Required:

Comment on the financial assistant's observations and show how the convertible loan note should be accounted for in Pingway's income statement for the year ended 31 March 2008 and statement of financial position as at that date.

(10 marks)