3 Epsilon is a listed entity. You are the financial controller of the entity and its consolidated financial statements for the year ended 30 September 2010 are being prepared. Your assistant, who has prepared the first draft of the statements, is unsure about the correct treatment of a transaction and has asked for your advice. Details of the transactions are given below:

Transaction (a)

On 1 October 2009 Epsilon issued 5 million loan notes that had a value of $1 per note. The issue costs were 3 cents per note. Each note holder will receive interest of 5 cents per note on 30 September of each year starting on 30 September 2010. The loan notes are repayable on 30 September 2019 at $1·20 per note. As an alternative to repayment the loan note holders can elect to exchange their notes for shares in Epsilon. On 1 October 2009 the credit rating of Epsilon was such that it would have had to offer investors in non-convertible loan notes a rate of return of 9% per annum on any investment. The impact of issue costs would increase the effective interest rate on such loan notes to 9·45%.

The following information regarding discount rates may be relevant

Discount rate	Present value of $1 receivable at the end of year 10	Cumulative present value of $1 receivable at the end of years 1–10
5%	61 cents	$7·72
9%	42 cents	$6·42

(6 marks)

Required:

For this transaction prepare extracts from the financial statements for the year ended 30 September 2010. Your extracts should be supported by appropriate explanations.