

Directors' Loans - Optional Interim Relief for Small Entities

7 June 2017

BACKGROUND

Small entities fell within the scope of FRS102 for accounting periods commencing on or after 1 January 2016. Under FRS102, a notional interest charge, based on a market rate, had to be calculated and recognised in the profit and loss account where the terms of non-fixed term loan were not at an arm's length price. The terms of loans from directors are commonly at a non-arm's length price with no set repayment date, often at a zero percent coupon.

The Financial Reporting Council, the UK standard setter, has acknowledged that in the context of smaller owner-managed businesses, many question the value of the notional interest charge, especially where the notes to the accounts adequately disclose the nature and terms of outstanding directors' loans.

RELIEF FOR SMALLER ENTITIES

For those smaller entities that are subject to Section 1A of FRS102, a new exposure draft, FRED 67 has been issued. This includes a proposed exemption for smaller entities from the requirement to calculate and recognise a market rate of interest for loans from director shareholders or close family of director shareholders.

EFFECTIVE DATE

The changes proposed in FRED 67 are not expected to be finalised until December 2017 which would be too late to benefit most smaller entities. Therefore, the FRC has, as an optional interim measure, amended FRS102 to include the following paragraph:

1.15A A small entity, as an exception to paragraph 11.13 may measure a basic financial instrument that is a loan from a director who is a natural person and a shareholder in the small entity (or a close family member of that person) initially at transaction price. Subsequently, for the same financial liability, a small entity is also exempt from the final sentence of paragraph 11.14(a)

This has the effect of removing the requirement to include a notional interest charge. This amendment is effective immediately with retrospective application available.

Where a small entity has already issued financial statements that comply with FRS102 prior to the interim measure being

available, the exemption will be available in any subsequent financial period, with full retrospective application required.

DISCLOSURE

For any loans with directors or shareholders, disclosure will still be required for non-market rate loans, including the amount and terms of the loan.

OTHER NON-MARKET RATE LOANS

Non-market rate loans with parties other than director shareholders or members of the close family of director shareholders such as loans from corporate shareholder directors or group entities will still require calculation and recognition of a notional interest rate charge in the profit and loss account.

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