# Accounting for Staff Loans – Indian GAAP *vs.* Ind-AS

***Financial reporting in India is expected to change tremendously due to applicability of Ind-AS, since current Indian GAAP (Generally Accepted Accounting Principles) are divergent from the notified Ind-AS in many respects. Accounting for staff loans is one such area where Ind-AS differs from Indian GAAP, even though the effective impact on the bottom line over the years shall be the same under both Indian GAAP and Ind-AS, the presentation of the transaction differs in Ind-AS, since Ind-AS tend to portray the effective substance of a transaction. This article attempts to explain the change in the accounting of staff loans due to implementation of Ind-AS. Read on…***

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## Applicability of Ind-AS

The Ministry of Corporate Affairs (MCA) notified the Companies (Indian Accounting Standards) Rules, 2015 on 16th February, 2015 which specify the Indian Accounting Standards (Ind-AS) applicable to certain class of companies and set out the dates of applicability. As per the notified roadmap, the following companies need to adopt Ind-AS for accounting periods beginning on or after 1st April, 2016:

- Companies whose equity or debt securities are listed or are in the process of listing on any stock exchange in India or outside India (listed companies) and having net worth of ₹500 crore or more.
- Unlisted companies having a net worth of ₹500 crore or more.
- Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.

The following companies need to adopt Ind-AS for accounting periods beginning on or after 1st April 2017:

- Listed companies having net worth of less than ₹500 crore.
- Unlisted companies having net worth of ₹250 crore or more but less than ₹500 crore.
- Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.

However, the roadmap is not applicable to insurance companies, banking companies, non-banking financial companies (NBFC) and companies whose securities are listed or in the process of listing at SME exchanges or on the institutional trading platform without initial public offering.

Further, any company may voluntarily adopt Ind-AS for financial statements for accounting periods beginning on or after 1st April 2015, with the comparatives for the periods ending 31st March 2015 or thereafter. Once a company opts to follow the Ind-AS (either voluntarily or mandatorily), it will be required to follow the same for all the subsequent financial statements.

## Staff Loans - Overview

Companies often extend advantageous loans at below-market/zero interest rates to its staff as a part of their compensation plan. The loans are extended over specified tenure and are subject to fixed repayment schedule as per the company's policy. These subsidised loans may be subject to certain conditions like continuation of service with the company, *etc*.

However, in assessing whether the interest charged on a loan is at a below-market rate, an entity should consider the terms and conditions of the loan, local industry practice and local market circumstances. The characteristics of staff loans do not necessarily reflect the characteristics of similar loans made to the customers as the underlying credit risks and recovery mechanisms differ. Thus, it can be articulated that whilst the loan is at a lower rate of interest, other market participants in similar industry may actually be providing loans to staff at similar rates of interest. Accordingly, it is a matter of judgment to arrive at the conclusion that whether a loan is at advantageous terms to the staff or not.

## Accounting Treatment under Indian GAAP

The staff loans are recognised in the financial statements equivalent to the amount disbursed. The interest income for the period is recognised at the contracted rate (the subsidised rate) in the statement of profit and loss by the company. There is no specific guidance under Indian GAAP to recognise such loans at fair value.

## Accounting Treatment under Ind-AS

Ind-AS require the staff loans to be recognised at fair value and the accounting treatment can be classified into the following transactions:

### 1. Initial Recognition

Para 5.1.1 of Indian Accounting Standard (Ind-AS) 109, *Financial Instruments inter alia* states that *"at initial recognition, an entity shall measure a financial asset or financial liability at its fair value".* Hence, an entity would be required to recognise the loans advanced to the employees at its fair value in the books of accounts.

The para B5.1.1 of application guide provided in Appendix B to Ind-AS 109 *inter alia* states that *'the fair value of a financial instrument at initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received. However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market*

**Accordingly, the guidance in this respect is very clear under Ind-AS that loans advanced at zero or concessional rates of interest are to be measured at fair value which is to be calculated using effective interest method.**

*rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating."*

Accordingly, the guidance in this respect is very clear under Ind-AS that loans advanced at zero or concessional rates of interest are to be measured at fair value which is to be calculated using effective interest method.

**2. Recognition of Interest Income**

Para 5.4.1 of Ind-AS 109 provides that *"interest revenue shall be calculated by using the effective interest method."* The effective interest method uses the financial instrument's carrying amount in the books of accounts as the principal value for the calculation of interest.

Accordingly, the interest income is recognised in the books of accounts as per the market rate and not the interest rate as per the concessional terms. However, the principal for the purpose of calculation of interest shall be the amortised cost and not the principal amount outstanding.

**3. Treatment of Difference between Transaction Value and Fair Value and its Subsequent Measurement**

Since the advancement of loans at zero/concessional rate of interest are made to the eligible employees as per the terms of service, the implied benefit is on the basis of the services rendered by the employee. Para 7 of Indian Accounting Standard (Ind-AS) 19 *'Employee Benefits'* defines employee benefits as all forms of consideration given by an entity in exchange for service rendered by employees. Accordingly, the implied benefit has to be recognised as employee benefit expense.

Further, the amortisation of the difference depends upon the continued availability of the

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benefit to the employee. Where the availability of concessional interest rate is not dependent on continued employment, then there should be a rebuttable presumption that the interest benefit relates to past services, and the cost should be recognised in profit or loss immediately.

Where the benefit relates to services to be rendered in future periods, for example, if the interest benefit will be forfeited if the employee leaves or is a bonus for future services - then the amount of the discount may be treated as a prepayment and expensed in the period in which the services are rendered.

## Case Study

To understand the accounting treatment in a better way, it is important to analyse the same through a practical example.

**Question** - ABC Limited advances loans for purchase of house to their employees who have completed three years of service at 4% while the current bank rate for housing loans is 10%. It has advanced ₹1,00,000/- to an employee, Mr. S, to be repaid in equal instalments over 5 years. Specify the accounting treatment under the Indian GAAP and Ind-AS.

**Answer** - The treatment of initial recognition, interest income and the differential amount is being summarised in the Table 1.

| | | Indian GAAP | | | Ind-AS | | | |
|---|---|---|---|---|---|---|---|---|
| **Year** | **Annual Instalment** | **Interest Income** | **Principal Repaid** | **Amount O/s** | **Interest Income** | **Principal Repaid** | **Effective Amount O/s** | **Employee Benefit** |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) |
| 0 | | | | 1,00,000 | | | 85,152 | 14,848 |
| 1 | 22,463 | 4,000 | 18,463 | 81,537 | 8,515 | 13,948 | 71,204 | -4,515 |
| 2 | 22,463 | 3,262 | 19,201 | 62,336 | 7,120 | 15,343 | 55,861 | -3,858 |
| 3 | 22,463 | 2,493 | 19,970 | 42,366 | 5,586 | 16,877 | 38,984 | -3,093 |
| 4 | 22,463 | 1,696 | 20,767 | 21,599 | 3,899 | 18,564 | 20,420 | -2,203 |
| 5 | 22,463 | 864 | 21,599 | - | 2,043 | 20,420 | - | -1,179 |
| Total | 1,12,315 | 12,315 | 1,00,000 | | 27,163 | 85,152 | | - |

**Table 1**

The accounting treatment and entries under Indian GAAP and Ind-AS are being summarised below:

| S. No. | Transaction | Accounting under Indian GAAP | Accounting under Ind-AS |
|---|---|---|---|
| 1. | **Recognition of Staff Advance at Transaction Date** | The loan will be recognised in the books at ₹1,00,000/-. | The loan will be recognised in the books at ₹85,152/- calculated using effective interest method. |
| 2. | **Recognition of Interest Income** | The interest income shall be recognised as per the amounts specified in Column 3 of Table 1, which is at the contracted rate (4%). | The interest income shall be recognised as per the amounts specified in Column 6 of Table 1, which is at market rate (10%). |
| 3. | **Treatment of Repayment** | The loan shall be reduced by the principal repayment each year (Col. 4) and the principal outstanding in the books at the end of each year shall be the amounts being displayed in Column 5 of Table 1. | The loan shall be reduced by the effective principal repayment each year (Col. 7) using amortised cost method and the principal outstanding in the books at the end of each year shall be the amounts being displayed in Column 8 of Table 1. |
| 4. | **Treatment of Difference between Transaction Value and Fair Value and its Subsequent Measurement** | Not Applicable, since the loan is recognised at the transaction value only. | If the concessional rate is contingent upon continuity of service, the difference of ₹14,848 shall be amortised over 5 years as employee benefit expense as per the amount mentioned in Column 9 of Table 1 using effective interest cost. Till the time the difference is fully amortised, the amount shall be presented as prepaid employee benefit expense in the balance sheet. However, if the concessional rate of interest shall be available for the entire tenure of loan irrespective of the continuity of Mr. S's service, the implied benefit has already been earned and hence, needs immediate recognition as employee benefit expense. Accordingly, no further expense shall be booked in subsequent years. |

As it can be seen from the Table 1, total interest income recognised under Indian GAAP is ₹ 12,315/- whereas, the total interest income recognised under Ind-AS will be ₹27,163/-. However, an amount of ₹14,848/- is recognised as employee benefits expense as well over the tenure of the loan under Ind-AS.

Hence, over the tenure of loan, the net impact on profit is ₹12,315/- only under Indian GAAP and Ind-AS both, but the impact and presentation varies during the tenure of loan.

## Conclusion

As clearly visible in the discussion above, the accountant's life under Ind-AS is going to get more complex. Just like in the instant case of accounting for staff loans, even though the effective impact on the bottom line over the years shall be the same under both Indian GAAP and Ind-AS, the presentation of the transaction differs in Ind-AS, since Ind-AS tend to portray the effective substance of a transaction. With a roadmap clearly visible for the implementation of Ind-AS in the country, the need of the hour is to understand the practical differences between the existing Indian GAAP and the converged Ind-AS and plan to implement it smoothly. ■

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