

Example 1

A parent company provides a fixed term interest-free loan of £1,000,000 to its subsidiary. The present value of the loan using a market rate of interest for a similar loan is £900,000. The difference of £100,000 represents an additional investment by the parent in the subsidiary.

The parent would record the following accounting entries in its individual financial statements:

Dr Loan receivable from subsidiary	£900,000
Dr Investment in subsidiary	£100,000
Cr Bank	£1,000,000

The subsidiary would record the following accounting entries:

Dr Bank	£1,000,000
Cr Loan repayable to parent	£900,000
Cr Capital contribution Account (in equity)	£100,000

Example 2

One company A Ltd makes a fixed term interest-free loan of £1,000,000 to B Ltd. Both A Ltd and B Ltd are owned by the same person (say Mr X). The present value of the loan using a market rate of interest for a similar loan is £900,000.

A Ltd would record the following accounting entries in its financial statements:

Dr Loan receivable from B Ltd	£900,000
Dr Distribution (in equity)	£100,000
Cr Bank	£1,000,000

B Ltd would record the following accounting entries:

Dr Bank	£1,000,000
Cr Loan repayable to A Ltd	£900,000
Cr Capital contribution Account (in equity)	£100,000

Example 3

A director/shareholder (Mr X) provides a fixed term interest-free loan of £1,000,000 to A Ltd, a company owned by Mr X. The present value of the loan using a market rate of interest for a similar loan is £900,000. The difference of £100,000 represents an additional investment by the owner which is recorded by A Ltd as a capital contribution

A Ltd would record the following accounting entries in its financial statements:

Dr Bank	£1,000,000
Cr Loan repayable to Mr X	£900,000
Cr Capital Contribution Account (in equity)	£100,000

Example 4

A company A Ltd provides a fixed term interest-free loan of £1,000,000 to a director/shareholder (Mr X) who owns A Ltd. The present value of the loan using a market rate of interest for a similar loan is £900,000. The loan is considered to be provided to the director in his capacity as a shareholder. The difference of £100,000 represents a distribution from A Ltd to its owner.

A Ltd would record the following accounting entries in its financial statements:

Dr Loan receivable from Mr X	£900,000
Dr Distribution (in equity)	£100,000
Cr Bank	£1,000,000

What are the accounting entries if an interest-free loan is made between a company and its director who does not own any shares in that company. The terms of the loan and the reasons for making it should be assessed carefully as this will be relevant for determining the accounting treatment under FRS 102.

Example 5

A company A Ltd provides a fixed term interest-free loan of £1,000,000 to a director (Mr X) who owns no shares in A Ltd. The present value of the loan using a market rate of interest for a similar loan is £900,000. This is likely to be treated as an employee benefit and will be accounted for in accordance with section 28 of FRS 102.

A Ltd would record the following accounting entries in its financial statements:

Dr Loan receivable from Mr X	£900,000
Dr Staff cost in Profit and Loss	£100,000
Cr Bank	£1,000,000

Example 6

A director (Mr X) of a company A Ltd, who owns no shares in A Ltd provides a fixed term interest-free loan of £1,000,000 to A Ltd. The present value of the loan using a market rate of interest for a similar loan is £900,000.

The accounting treatment in A Ltd would depend on why Mr X agreed to lend the money to A Ltd.

Mr X may be receiving a salary of £300,000 per annum from A Ltd and he may have been told by A Ltd that if he is not willing to lend the company the £1,000,000 then his salary will be reduced to £150,000.

A Ltd would record the following accounting entries in its financial statements:

Dr Bank	£1,000,000
Cr Staff costs in Profit and Loss	£100,000
Cr Loan payable to Mr X	£900,000

Example 7

On 1 January 2017 S Ltd obtains an interest free loan of £1,000,000 from its parent company P Ltd. The loan is repayable in full on 31 December 2018. The market rate of interest for similar loans is 8% per annum. At 1 January 2017 the net present value of the loan is $£1,000,000/1.08^2 = £857,339$ and at 1 January 2018 the net present value of the loan is $£1,000,000/1.08 = £925,926$.

Therefore interest accruing during the year ending 31 December 2017 will be £68,587 and during the year ending 31 December 2018 will be £74,074.

The accounting entries for this loan will be as follows:

In accounts of S Ltd

At 1 January 2017

Dr Bank	£1,000,000
Cr Capital Contribution Account (equity)	£142,661
Cr Loan repayable to P Ltd	£857,339

Journal on 31 December 2017

Dr Interest (profit & loss)	£68,587
Cr Loan repayable to P Ltd	£68,587

Journal on 31 December 2018

Dr Interest (profit & loss)	£74,074
Cr Loan repayable to P Ltd	£74,074
Cr Bank	£1,000,000
Dr Loan repayable to P Ltd	£1,000,000

In accounts of P Ltd

At 1 January 2017

Dr Loan to S Ltd	£857,339
Dr Investment in subsidiary	£142,661
Cr Bank	£1,000,000

Journal at 31 December 2017

Dr Loan to S Ltd	£68,587
Cr Interest receivable (profit & loss)	£68,587

Journal at 31 December 2018

Dr Loan to S Ltd	£74,074
Cr Interest receivable (profit & loss)	£74,074
Dr Bank	£1,000,000
Cr Loan to S Ltd	£1,000,000

Clearly where 'terms' exist the transactions will follow the requirements. Where terms do not exist written or verbal, for example a loan from a Director with no terms that has been outstanding for a considerable time judgement will be required on the appropriate treatment following discussion with the Director.