Financial Reporting Council

Accounting and Reporting Policy
FRS 102

Staff Education Note 16
Financing transactions

Disclaimer

This Education Note has been prepared by FRC staff for the convenience of users of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. It aims to illustrate certain requirements of FRS 102, but should not be relied upon as a definitive statement on the application of the standard. The illustrative material is not a substitute for reading the detailed requirements of FRS 102.

Contents

Introduction

Lending is a very common transaction between entities. For example, it may take the form of a formal bank loan or informal overdraft or take the form of a purchase or sale on credit. The receivable and payable recognised by the lender and borrower respectively, are accounted for in accordance with the requirements set out in Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instruments Issues* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

In some situations the seller and buyer of goods or services may agree that payment can be deferred for a period that is longer than what is normal business practice. Loans, most commonly loans between related parties, may be financed at an interest rate that is lower than the rate that would typically be charged for a similar loan or the loan may even be interest-free. FRS 102 refers to these types of lending arrangements as financing transactions. FRS 102 sets out separate accounting requirements for financing transactions which in essence require that the loan is measured as if it was a loan with a market rate of interest.

This Education Note provides guidance on the application of the measurement requirements in FRS 102 applicable to financing transactions. It also sets out a comparative analysis of the key accounting requirements for financing transactions under FRS 102 and those applicable under previous UK and Irish GAAP.

Entities are reminded that this Education Note does not cover all aspects of the accounting for financing transactions. The examples included are simplified to illustrate the application of certain aspects of the accounting requirements and do not cover all possible accounting issues. In practice entities need to take into consideration all relevant facts and circumstances of a transaction to determine the appropriate accounting.

Staff Education Note 2 *Debt instruments - Amortised cost* provides further guidance on the accounting for financial assets and financial liabilities measured at amortised cost using the effective interest method when a lending arrangement does not constitute a financing transaction in the context of FRS 102.

This Education Note does not address the accounting for public benefit entity concessionary loans made or received at or below the prevailing market rate of interest. Please refer to paragraphs PBE34.87 to PBE34.97 of FRS 102 for the applicable accounting requirements.

This Education Note is based on the requirements of FRS 102 issued in September 2015.

Measurement of financing transactions

The term financing transaction is used in FRS 102 to specifically refer to transactions with deferred payments or repayments, for which there is no explicit interest rate or the interest charged is not at a market rate. Examples of such transactions include:

- the sale of goods or services, if payment is deferred beyond normal business terms or is financed at a rate of interest that is not a market rate (paragraph 11.13 of FRS 102);
- below market rate and interest-free loans between group entities; and
- below market rate and interest-free loans to or from directors.

Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues* of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* set out specific measurement requirements for financial assets and financial liabilities where the arrangement constitutes a financing transaction. The following discussions are limited to the requirements in Section 11 and therefore only apply to financial assets and financial liabilities that are classified as basic. Please refer to paragraphs 11.8 to 11.11 of FRS 102 which specify the conditions for a financial asset or financial liability to be classified as a basic financial instrument.

Initial measurement

Paragraph 11.13 of FRS 102 sets out the initial measurement requirements for financial assets and financial liabilities. Generally financial assets and financial liabilities are measured at their transaction price, which typically is the amount of cash borrowed or the invoiced amount when goods or services are sold. However, when a financial asset or financial liability, ie a receivable or payable, originates from an arrangement that is a financing transaction, that receivable or payable is measured at the present value of the future cash payments discounted at a market rate of interest for a similar debt instrument[1] (paragraph 11.13 of FRS 102).

Below are five common examples of financing transactions where the loan has a fixed repayment date to demonstrate the application of the present value measurement requirement of paragraph 11.13 of FRS 102.

It should be noted that the present value of a financial asset or financial liability that is repayable on demand is equal to the undiscounted cash amount payable reflecting the lender's right to demand immediate repayment.

The sale of goods or services on deferred payment terms

When goods or services are sold on credit, the arrangement has in substance two components, firstly the sale of the goods or services and secondly a financing element. The two components are accounted for separately.

To that effect a seller recognises the revenue from the sale in accordance with Section 23 *Revenue* of FRS 102 and a purchaser recognises the acquired goods and services in accordance with the applicable accounting requirements in FRS 102.

When the arrangement is a financing transaction, ie when the payment for goods or services is deferred beyond normal business terms or the sale is financed at a below market rate of interest, the trade debtor and trade creditor are measured at the present value of the cash flows receivable or payable discounted at the market rate of interest for a similar receivable or

[1] Debt instruments include loans receivable, loans payable, trade debtors and trade creditors.

payable (paragraph 11.13 of FRS 102). In practice, an entity may use the current cash selling price for the goods or services sold on an arm's length basis as an estimate for the present value of the future payments. However, if there is no cash sale alternative or the cash selling price is the same as the price when buying on credit, the entity must calculate the present value of the future cash flows.

The following numerical example demonstrates the accounting by a seller (the manufacturer) and a buyer (the customer) when payment is deferred.

Example 1: The sale of goods on deferred payment terms

A manufacturer sells a piece of machinery to a customer on credit for CU1,000 on 1 January 20X0, agreeing with the customer that full payment is due in two years' time on 31 December 20X1. Under normal business terms the piece of machinery is sold for cash and the current cash selling price is CU900. Sales taxes are ignored in this example.

(1) Accounting by the manufacturer

In accordance with paragraph 23.5 of FRS 102, on 1 January 20X0 the manufacturer recognises the revenue from the sale at the cash selling price of the piece of machinery of CU900. The trade receivable is also measured at the cash selling price of CU900 in accordance with paragraph 11.13 of FRS 102. The manufacturer records the following accounting entries when the piece of machinery is sold:

Dr Trade receivable	CU900
Cr Revenue	CU900

After initial recognition the manufacturer will account for the trade receivable at amortised cost using the effective interest method as demonstrated in Example 6 below. In accordance with paragraph 23.5 of FRS 102, the difference between the present value of the trade receivable of CU900 and the nominal amount of the consideration of CU1,000 is recognised as interest income using the effective interest method over the two years until payment is due from the customer.

(2) Accounting by the customer

The customer applies the requirements of Section 17 *Property, Plant and Equipment* of FRS 102. In accordance with paragraph 17.13 of FRS 102, on 1 January 20X0 the purchase of the piece of machinery is recorded at the cash selling price of CU900. The customer also records a trade payable measured at the cash selling price of CU900 in accordance with paragraph 11.13 of FRS 102. The customer records the following accounting entries when the piece of machinery is purchased:

Dr Property, plant and equipment	CU900
Cr Trade payable	CU900

After initial recognition the customer accounts for the trade payable at amortised cost using the effective interest method as demonstrated in Example 6 below.

Fixed term loans with no interest or a below market rate of interest

A loan provided or received at no or a below market rate of interest constitutes a financing transaction. Paragraph 11.13 of FRS 102 requires that such a loan is measured at the present value of the future cash receipts or payments discounted at a market rate of interest of a similar financial asset or financial liability.

The present value calculated in accordance with paragraph 11.13 of FRS 102 reflects the value of a similar loan with a market rate of interest. For loans other than those repayable on demand, a difference arises between the amount of cash received or advanced and the present value of the loan. This difference reflects that the lender has made a loan at a lower than market rate of interest and thereby has provided an additional benefit to the borrower.

FRS 102 does not set out specific accounting requirements for that difference. Where FRS 102 does not specifically address the accounting for a transaction, an entity applies judgement to determine the accounting treatment that meets the requirements of paragraph 10.4 of FRS 102, ie an entity selects an accounting policy that results in relevant and reliable information. Paragraph 10.5 sets out the sources an entity should consider for that analysis.

To determine the accounting treatment for the difference, an entity should assess the particular facts and circumstances of each arrangement. In that regard it is particularly important to establish the reasons a lender decided to make a loan at a non-market rate of interest. For example a lender may make the loan because of an ownership interest in the borrower. If so, the lender is, in its capacity as the owner, effectively making an additional investment in the entity when making a loan at a below market rate of interest. In other instances there may be related transactions to consider, for example the lender may be compensated by obtaining goods or services from the borrower at below market prices.

Where a loan is made at a non-market rate of interest and the lender and the borrower are related parties because one owns the other or the lender and borrower are owned by the same entity or person, the difference arising on initial recognition of the loan would generally be accounted for as a distribution or capital contribution.

FRS 102 sets out accounting requirements for distributions. For the entity making a distribution it represents a decrease of economic benefits that results in a decrease in equity. A distribution is not an expense and is therefore recorded as a reduction of equity (paragraphs 2.23(b) and 22.17 of FRS 102). It should be noted that in some cases a distribution may be recorded in the financial statements in accordance with FRS 102, although it may not be a distribution as a matter of law and vice versa. An entity that is subject to company law should consider whether the distribution recorded in the financial statements for reporting purposes is also a distribution as a matter of the law and if so, should assess whether it has sufficient distributable profits to make the distribution.

The entity receiving a distribution records it as an income, since it represents an increase in economic benefits that results in an increase of equity that is not related to a capital contribution from an equity investor (paragraph 2.23(a) of FRS 102). Income is recorded in total comprehensive income, either in profit or loss or in other comprehensive income. Company law prohibits the inclusion of unrealised profits within profit or loss, except where an unrealised revaluation gain arises from the application of fair value accounting. If the distribution is considered a realised profit it is recorded in profit or loss, otherwise it is recorded in other comprehensive income. An entity that is a company should assess whether the distribution received is a realised profit within the meaning of company law.

The determination of realised and distributable profits in accordance with company law is a complex area where accounting and legal requirements interface. This Education Note does not address company law issues that may be relevant in this regard. An entity may refer to

Technical Release 02/10 *Guidance on realised and distributable profits under the Companies Act 2006* (Technical Release 02/10) issued by the Institute of Chartered Accountants in England and Wales and the Institute of Chartered Accounts of Scotland, or any successor document. An entity may also wish to take specialist legal advice on these matters.

Capital contributions from equity investors do not meet the definition of income (see paragraph 2.23(a) of FRS 102). A capital contribution is therefore recorded by the receiving entity as an increase in equity. The entity making a capital contribution records it as an increase in its investment in the entity receiving the capital contribution.

The Examples 2 to 5 below illustrate different scenarios of interest-free loan arrangements between related parties and demonstrate the accounting for the difference.

Example 2: Fixed term interest-free loans between a parent and its subsidiary

Loans between parents and their subsidiaries are often made on interest-free terms. It can be presumed that a loan is made on these terms because the parent owns and controls its subsidiary.

A fixed term interest free-loan consists, in substance, of two components:

(a) a loan at a market rate of interest; and

(b) a benefit or contribution to the borrower.

In the case of an interest-free loan between a parent and its subsidiary, the first component, ie the loan made at a market-rate of interest, is determined by calculating the present value of the future payments discounted at a market rate of interest of a similar loan. The second component, ie the gift or contribution to the borrower, is the measurement difference which is accounted for as a capital contribution or distribution. The accounting is demonstrated in the numerical examples below.

(1) A parent provides a fixed term interest-free loan of CU1,000 to its subsidiary. The present value of the loan using a market rate of interest for a similar loan is CU900[2]. The difference of CU100 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[3]	CU900
Dr Investment in subsidiary[3]	CU100
Cr Cash	CU1,000

The subsidiary would record the following accounting entries:

Dr Cash	CU1,000
Cr Loan repayable to parent	CU900
Cr Capital contribution (equity)	CU100

[2] See Example 6 below for the calculation of the present value and a demonstration of the subsequent accounting for an interest-free loan.

[3] Loans and investments are subject to impairment. An entity shall apply the relevant accounting requirements in FRS 102 to determine whether a loan or investment is impaired.

(2) A subsidiary provides a fixed term interest-free loan of CU1,000 to its parent. The present value of the loan using a market rate of interest for a similar loan is CU900[4]. The difference of CU100 is a distribution to the parent. The parent would record the following accounting entries in its individual financial statements:

Dr Cash	CU1,000
Cr Loan repayable to subsidiary	CU900
Cr Distribution received from subsidiary (profit or loss)[5]	CU100

The subsidiary would record the following accounting entries:

Dr Loan receivable from parent	CU900
Dr Distribution to parent (equity)[6]	CU100
Cr Cash	CU1,000

Example 3: Fixed term interest-free loans between fellow subsidiaries

In a situation where fellow subsidiaries enter into a loan which constitutes a financing transaction, it can generally be presumed that the loan was made on the direction of their parent. However, sometimes the facts and circumstances may indicate otherwise, for example when an interest-free loan is made in return for receiving goods or services at a discounted price.

If an interest-free loan is made on the direction of the parent, the subsidiaries account for the transaction as if it had been conducted through the parent. The lending subsidiary accounts for the loan as if it had made a loan to its parent and the borrowing subsidiary accounts for the loan as if it had received a loan from its parent. The transaction is not required to be reflected in the parent's own financial statements because the parent is not directly involved.

As noted in Example 2 above, a fixed term interest-free loan consists, in substance, of two separate components. In the case of an interest-free loan between fellow subsidiaries, the first component represents a loan made at a market-rate of interest and the second component is a distribution or capital contribution. The accounting is demonstrated in the following numerical example.

---

[4] See Example 6 below for the calculation of the present value and a demonstration of the subsequent accounting for an interest-free loan.

[5] Company law requires that only profits realised at the reporting date are included in profit or loss. For the purpose of this example it is assumed that the distribution is a realised profit and it is therefore recorded in profit or loss. The legal requirements on realised profits are not addressed in this Education Note. Technical Release 02/10 considers issues concerning the determination of realised profits and entities may refer to this or any successor document for more guidance.

[6] In accordance with paragraph 22.17 of FRS 102 a distribution is recorded as a reduction of equity. A distribution recorded in the financial statements in accordance with FRS 102 may not be a distribution as a matter of law. The legal requirements on distributable profits are not addressed in this Education Note. Technical Release 02/10 considers issues concerning the determination of distributable profits and entities may refer to this or any successor document for more guidance.

A subsidiary makes a fixed term interest-free loan of CU1,000 to a fellow subsidiary. The present value of the loan using a market rate of interest for a similar loan is CU900[7]. The excess of the cash advanced over the present value of the loan of CU100 is accounted for as a distribution from the lending subsidiary. The accounting entries of the lending subsidiary are as follows:

Dr Loan receivable from fellow subsidiary	CU900
Dr Distribution (equity)[8]	CU100
Cr Cash	CU1,000

The borrowing subsidiary would account for the excess of CU100 as a capital contribution and record the following accounting entries:

Dr Cash	CU1,000
Cr Loan repayable to fellow subsidiary	CU900
Cr Capital contribution (equity)	CU100

Example 4: Fixed term interest-free loans between entities owned by the same person

In some instances an interest-free loan is made between entities that are not members of the same group, but the entities are related parties because they are owned and controlled by the same person. Unless the facts and circumstances indicate that the loan is made on these terms for a reason other than that the entities are controlled by the same owner, the accounting for the loan will be the same as shown in Example 3 above for a fixed term interest-free loan between fellow subsidiaries.

As noted in Example 2 above, a fixed term interest-free loan consists, in substance, of two separate components. In the case of a fixed term interest-free loan between entities that are owned by the same person, the first component represents a loan made at a market-rate of interest and the second component is a distribution or capital contribution. The accounting is demonstrated in the numerical example below.

An entity makes a fixed term interest-free loan of CU1,000 to another entity. Both entities have the same owner. The present value of the loan using a market rate of interest for a similar loan is CU900[7].

The lending entity records the following accounting entries:

Dr Loan receivable from related party	CU900
Dr Distribution (equity)[8]	CU100
Cr Cash	CU1,000

The borrowing entity records the following accounting entries:

Dr Cash	CU1,000
Cr Loan repayable to related party	CU900
Cr Capital contribution (equity)	CU100

---

[7] See Example 6 below for the calculation of the present value and a demonstration of the subsequent accounting for an interest-free loan.

[8] In accordance with paragraph 22.17 of FRS 102 a distribution is recorded as a reduction of equity. A distribution recorded in the financial statements in accordance with FRS 102 may not be a distribution as a matter of law. The legal requirements on distributable profits are not addressed in this Education Note. Technical Release 02/10 considers issues concerning the determination of distributable profits and entities may refer to this or any successor document for more guidance.

Example 5: Fixed term interest-free loans between entities and their directors

A fixed term interest-free loan may be made between an entity and its director(s). The accounting for the measurement difference arising on the initial recognition of the loan will depend on whether the loan was made in the director's capacity as a shareholder or for another reason. For example, in a situation where a director is the majority shareholder it can be presumed that the loan was made in the director's capacity as a shareholder. This presumption can be rebutted, if, for example, loans between the entity and other third parties without an ownership interest in the entity (eg employees) are made on the same or similar terms.

If a fixed term interest-free loan is made between the entity and a director in its capacity as a shareholder the accounting for the loan is similar to the accounting for a fixed term interest-free loan between a parent and its subsidiary shown in Example 2 above.

As noted in Example 2, a fixed term interest-free loan consists, in substance, of two components. In the case of a fixed term loan between an entity and a director who is also a shareholder, the first component represents a loan at a market rate of interest and the second component is a capital contribution or distribution between the director and the entity. The numerical examples below demonstrate the accounting.[9]

(1) A director provides a fixed term interest-free loan of CU1,000 to an entity owned by the director. The loan is considered to be provided by the director in his/her capacity as a shareholder. The present value of the loan using a market rate of interest of a similar loan is CU900[10]. The difference of CU100 represents an additional investment by the owner which is recorded by the entity as a capital contribution. The entity would record the following accounting entries:

Dr Cash	CU1,000
Cr Loan repayable to owner/director	CU900
Cr Capital contribution (equity)	CU100

(2) An entity provides a fixed term interest-free loan of CU1,000 to a director who also owns the entity. The loan is considered to be provided to the director in his/her capacity as a shareholder. The present value of the loan using a market rate of interest of a similar loan is CU900[10]. The difference of CU100 represents a distribution from the entity to its owner. The entity would record the following accounting entries:

Dr Loan receivable from owner/director	CU900
Dr Distribution to owner (equity)[11]	CU100
Cr Cash	CU1,000

If an interest-free loan is made between an entity and a director who has no direct ownership interest in the entity, the terms of the loan and the reasons for making it should be assessed carefully as this is relevant for determining the appropriate accounting under FRS 102.

For example, an entity may offer interest-free loans to all employees, including its directors, as an additional employee benefit. Often these loans are made for a specific purpose, for

[9] Only the accounting entries for the entity are shown here as it is presumed that the director is not preparing financial statements in accordance with FRS 102.

[10] See Example 6 below for the calculation of the present value and a demonstration of the subsequent accounting for an interest-free loan.

[11] In accordance with paragraph 22.17 of FRS 102 a distribution is recorded as a reduction of equity. A distribution recorded in the financial statements in accordance with FRS 102 may not be a distribution as a matter of law. The legal requirements on distributable profits are not addressed in this Education Note. Technical Release 02/10 considers issues concerning the determination of distributable profits and entities may refer to this or any successor document for more guidance.

example to purchase a season travel ticket. In this situation the entity accounts for the measurement difference as an employee benefit cost in accordance with Section 28 *Employee Benefits* of FRS 102.

When a director without ownership interest makes a loan to the entity, the director's motives have to be identified, as the director would not normally directly benefit from making a loan on these terms. The appropriate accounting for the measurement difference will be dependent on the individual circumstances of each transaction.

Subsequent measurement

Basic financial assets and financial liabilities are generally measured at amortised cost using the effective interest method (paragraph 11.14(a) of FRS 102). This requirement applies regardless of whether the financial asset or financial liability results from an arrangement that constitutes a financing transaction or not.

The effective interest rate is determined in accordance with the requirements of paragraphs 11.16 to 11.20 of FRS 102. Assuming that the original effective interest rate as determined at the time of the initial recognition of the loan is a fixed rate of interest, the rate is not updated for subsequent changes to the market rate of interest. The following numerical example demonstrates the subsequent accounting for an interest-free loan.

Example 6: Subsequent measurement of interest-free loans

On 1 January 20X1 a subsidiary obtains an interest-free loan of CU1,000 from its parent. The loan is repayable in full on 31 December 20X2. The market rate of interest for similar loans is 5.4 per cent per annum. The net present value of the loan is CU900[12] ($1{,}000/1.054^2=900$). The amortised cost of the loan as at 31 December 20X1 and 20X2 is as follows:

Year	Carrying amount at 1 January CU	Interest accrued (5.4%) CU	Cash flow CU	Carrying amount at 31 December CU
20X1	900	49	—	949
20X2	949	51	(1,000)	—

On 1 January 20X1 the parent and the subsidiary would record the accounting entries set out in Example 2 above when a parent makes an interest-free loan to its subsidiary. As described in Example 2, at initial recognition the interest-free loan is accounted for as a loan at a market-rate of interest and a capital contribution or distribution. After initial recognition the interest-free loan is treated for accounting purpose as if it was a loan at a market rate of interest with capital and interest payable at the end of the term of the loan. Interest is accounted for applying the effective interest method.

The entity receiving interest (in this example the parent) records it as an income. Income is recorded in total comprehensive income, either in profit or loss or in other comprehensive income. Company law prohibits the inclusion of unrealised profits within profit or loss, except for an unrealised revaluation gain arising from the application of fair value accounting.

[12] 900 is a rounded figure.

If the interest income is considered a realised profit it is recorded in profit or loss, otherwise it is recorded in other comprehensive income. An entity that is a company should assess whether the interest income is a realised profit within the meaning of company law. The determination of realised profits in accordance with company law is a complex area where accounting and legal requirements interface. This Education Note does not address company law issues that may be relevant in this regard. An entity may refer to Technical Release 02/10, or any successor document. An entity may also wish to take specialist legal advice.

The entity paying interest (in this example the subsidiary) records it as an expense in profit or loss.

The parent would record the following accounting entries:

Year ended 31 December 20X1

To record the accrued interest

Dr Loan receivable from subsidiary	CU49
Cr Interest income[13]	CU49

Year ended 31 December 20X2

To record the accrued interest

Dr Loan receivable from subsidiary	CU51
Cr Interest income[13]	CU51

To record the loan repayment

Dr Cash	CU1,000
Cr Loan receivable from subsidiary	CU1,000

The subsidiary would record the following accounting entries:

Year ended 31 December 20X1

To record the accrued interest

Dr Interest expense	CU49
Cr Loan repayable to parent	CU49

Year ended 31 December 20X2

To record the accrued interest

Dr Interest Expense	CU51
Cr Loan repayable to parent	CU51

To record the loan repayment

Dr Loan repayable to parent	CU1,000
Cr Cash	CU1,000

[13] Company law requires that only profits realised at the reporting date are included in profit or loss. For the purpose of this example it is assumed that the interest income is a realised profit. The legal requirements on realised profits are not addressed in this Education Note. Technical Release 02/10 considers issues concerning the determination of realised profits and entities may refer to this or any successor document for more guidance.

Differences between FRS 102 and previous UK and Irish GAAP

The tables below present the key accounting requirements in FRS 102 and previous UK and Irish GAAP for the most common types of financing transactions[14], ie goods or services sold on deferred payment terms and loans made at a below market rate of interest.

As highlighted below accounting differences may arise on transition to FRS 102 in some cases.

The sale of goods or services on deferred payment terms

FRS 4/ FRS 5	FRS 102
Borrower (purchaser of the goods/services on extended credit terms)	
FRS 4 *Capital instruments* characterises a capital instrument as a means of raising finance. Where a transaction relates to a purchase on credit terms that is extended to the extent that there is a financing element to the transaction, the debt is recognised at the net proceeds, assumed to be the fair value of the goods or services received. The difference between the fair value and the amount to be paid is the finance cost, to be allocated to periods over the term of the debt at a constant rate on the carrying amount. (FRS 4 paragraphs 27 and 28)	If the transaction is a financing transaction the financial liability shall be measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. The cash price for the transaction could provide evidence of the present value of the transaction from which the effective interest rate can be calculated. (FRS 102 paragraph 11.13) The difference between the invoiced amount and the present value of the future payments is recognised as interest expense over the credit term using the effective interest method. (FRS 102 paragraph 11.14(a))
Lender (seller of the goods/services on extended credit terms)	
Revenue and the corresponding receivable are initially recognised at the present value of the cash inflows expected to be received from the customer on settlement, where the effect of the time value of money is material to the reported revenue. The unwinding of the discount should be credited to finance income as this represents a gain from a financing transaction. (FRS 5 Application Note G, paragraph G8)	Revenue is initially measured at the fair value of the consideration receivable. Where the inflow of cash is deferred, and the arrangement constitutes in effect a financing transaction, the fair value of the consideration is the present value of all future receipts determined using an imputed rate of interest. (FRS 102 paragraphs 23.3 and 23.5) The corresponding receivable shall be measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. The

[14] It should be noted that previous UK and Irish GAAP did not include the term financing transaction.

FRS 4/ FRS 5	FRS 102
	cash price for the transaction could provide evidence of the present value. (FRS 102 paragraph 11.13) The difference between the invoiced amount and the present value of the future receipts is recognised as interest income over the credit term using the effective interest method. (FRS 102 paragraph 11.14(a))

Not considered to be different.

Loans at a below market rate of interest[15]

FRS 4	FRS 102
Borrower	
The loan is recognised initially at the amount of the net proceeds[16], which in most cases would be the amount borrowed. (FRS 4 paragraph 27) Finance costs are defined as the difference between the net proceeds and the total payments. (FRS 4 paragraph 8) The finance costs should be allocated over the term of the debt at a constant rate on the amount borrowed. (FRS 4 paragraph 28)	When a lending arrangement constitutes, in effect, a financing transaction, the financial liability shall be measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. (FRS 102 paragraph 11.13) The difference between the cash received and the present value of the loan is recognised as interest expense over the period of the loan using the effective interest method. (FRS 102 paragraph 11.14(a))
Lender	
No specific accounting requirements apply (FRS 4.19 excludes investments in capital instruments from its scope) and current practice would be to recognise the loan at the amount advanced (usually the nominal value of the loan).	When a transaction constitutes, in effect, a financing transaction, the financial asset shall be measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument. (FRS 102 paragraph 11.13)

[15] This analysis does not apply to entities that adopted FRS 26 (IAS 39) *Financial Instruments: recognition and measurement* under previous UK and Irish GAAP. The measurement requirements for a loan at non-market rate under FRS 26 are similar to those in FRS 102.

[16] Defined in paragraph 11 of FRS 4 as “the fair value of the consideration received on the issue of a capital instrument after deduction of issue costs”.

FRS 4	FRS 102
	The difference between the cash loaned and the present value of the loan is recognised as interest income using the effective interest method. (FRS 102 paragraph 11.14(a))

Whilst under FRS 4 a loan with a below market rate of interest was measured at the amount of the net proceeds, FRS 102 requires that such a loan is measured initially at the present value of the future cash flows discounted at a market rate. Any difference arising on initial measurement is subsequently allocated over the term of the loan using the effective interest method.

Small entities[17] that first adopt FRS 102 for an accounting period that commences before 1 January 2017 need not restate comparative information to comply with the accounting requirements of paragraph 11.13 of FRS 102 for financing transactions involving related parties[17]. Small entities that apply this transitional exemption are also permitted to determine the present value of the financial asset or financial liability at the start of the first reporting period that complies with the requirements of paragraph 11.13 of FRS 102 on the basis of the facts and circumstances existing at that date, rather than when the arrangement was entered into. See paragraph 35.10(v) of FRS 102.

[17] Small entities and related parties are terms defined in FRS 102. Refer to the Glossary in FRS 102 for more detail.