HMRC - CFM22520 - Borrowers: Accounting Standards: FRS 4

The following guidance covers Old UK GAAP (applied before 2015) where FRS 26 was not applied.

A summary of FRS 4 in respect of debt

FRS 4 requires debt to be presented in financial statements in a way that reflects the obligations of the borrower. It prescribes methods to establish

whether the amount should be classified as debt,

the amounts at which the debt should be recorded,

the financing and issue costs and how these should be accounted for,

the term of the debt, and

the accounting for gains and losses on the repurchase of debt.

It also specifies relevant disclosures.

FRS 4 applies to all reporting entities whose financial statements are intended to give a true and fair view, irrespective of size or ownership.

Liabilities

Companies should classify as liabilities any capital instrument that contains an obligation to transfer economic benefits.

For convertible debt, conversion of debt should never be anticipated and convertible debt should be reported within liabilities. Convertible debt should be disclosed separately from other debt.

Carrying amount of debt

Immediately after issue, debt should be stated at the amount of the net proceeds, being the fair value of the consideration received from the debt instrument after deduction of issue costs.

The finance costs associated with debt are to be allocated to periods at a constant rate based on the carrying amount of the debt. For convertible debt the finance costs should be calculated on the assumption that the debt will never be converted. The finance cost for a period is added to the carrying amount of the debt and payments deducted from it. In the case of a redeemable instrument this will result in the carrying amount at the time it is redeemed being equal to the amount payable at that time.

Finance costs

Finance costs are defined as the difference between net proceeds of an instrument and the total amount of the payments (or other transfers of economic benefits) that the borrower may be required to make in respect of the instrument. This definition of finance costs includes issue costs as well as returns (e.g. interest, discount or premium) paid to the lender.

The finance cost for the period is taken to the profit and loss account.

Issue costs

Issue costs are those costs incurred directly in connection with raising of the specific debt instrument, which would not have been incurred had the instrument not have been issued. FRS 4 states the definition is deliberately restrictive.

Issue costs should be deducted from the gross amount of debt raised. Costs, which do not meet the definition of issue costs, should be charged to the profit and loss account as incurred.

Term

The term of the debt is from the date of issue of the instrument to the date it will expire, be redeemed or cancelled. The term is usually self evident but where either party has an option to extend the term or to redeem/cancel early, the option needs careful evaluation. Further guidance is given in the FRS4. You should seek advice from your HMRC accountant.

Repurchase of debt

Gains and losses arising on the repurchase or early settlement of debt should be recognised in the profit and loss account in the period during which the repurchase or early settlement is made.

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