

Accounting Treatment of Additional Interest Payable After Repayment of Loan Amount

The following is the brief version of an opinion given by the Expert Advisory Committee of the Institute in response to query sent by a member. This is being published for the information of readers.

A. Facts of the Case

1 A company is engaged in manufacture of 100% wood-free particle board made from sugarcane residue, i.e., bagasse.

2 As per the querist, the term lending institutions have sanctioned the company a restructuring package. The brief details of the package are as follows:

- (a) Waiver of compound interest and liquidated damages upto April 1, 2000.
- (b) Reduction in interest rate on all loans to 12.5% p.a., w.e.f. April 1, 2000.
- (c) Refixation of term loan repayment schedule.

3 As per the querist, while sanctioning this package, the term lending institutions have put up the following pre-condition, on account of loss of interest:

"Interest loss upto the terminal date of loan due to reduction in interest rate would be treated as deferred interest carrying zero coupon rate of interest and will be repayable in two equal annual instalments after repayment of entire term loan."

1. The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.

2. The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in 21 volumes which are available for sale at the Institute's office at New Delhi and its regional council offices at Mumbai, Chennai, Kolkata and Kanpur.

According to the querist, in this case, interest loss has been further discounted @ 12.5% to convert it into its present value.

4 The querist has further informed that one term lending institution has used the following clause instead of the above clause:

"In addition to the restructuring package mentioned in paragraph 2 above, the company would pay additional interest amounting to Rs. 15.3 million in two equal annual instalments after repayment of the entire loan."

5 As per the querist, the above additional interest also represents the loss of interest on account of reduction in interest rate over the period of the loan. In this particular case, differential interest portion has not been further discounted @ 12.5% as done by the other term lending institutions.

6 The querist has suggested the following three options for accounting for the additional interest:

- (a) Consider additional interest/deferred interest as deferred revenue expenditure by debiting the entire amount to deferred revenue expenditure account and crediting to deferred/additional interest account and write off over the period of the loan.
- (b) Debit interest loss of that year only to the profit and loss account by crediting to deferred interest/additional interest account.
- (c) Debit interest on actual payment basis.

7 The querist has informed that the term lending insti-

tutions will recognise deferred interest/additional interest as their income on receipt basis only.

B. Query

8 The querist has sought the opinion of the Expert Advisory Committee as to the accounting treatment of additional interest payable after the repayment of principal amount.

C. Points considered by the Committee

9 The Committee observes that the query has been raised in respect of accounting treatment in the books of the borrower company. The Committee has, therefore, not touched upon the accounting treatment to be followed by the term lending institutions. The Committee has also not touched upon the issue as to the manner of computation of additional interest and the accounting treatment of waiver of compound interest and liquidated damages, since these issues have not been raised by the querist.

10 The Committee notes that one of the fundamental accounting assumptions that underlies the preparation and presentation of financial statements is 'accrual'. Accounting Standard (AS) 1, 'Disclosure of Accounting Policies', issued by the Institute of Chartered Accountants of India, describes 'accrual' in paragraph 10 as below:

"c. Accrual

Revenues and costs are accrued, that is, recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate."

11 The Committee notes from the facts of the case that the term lending institutions have reduced the interest rate to 12.5% p.a. and for the interest loss due to reduction in the interest rate, additional interest is payable by the company after repayment of the entire loan amount. The Committee is of the view that though the restructuring package offered by the institutions has reduced the interest rate, apparently the difference between the original interest rate and the reduced interest rate is payable after repayment of the loan amount by way of additional interest. The Committee is of the view that the restructuring package has only deferred the partial pay-

ment of interest till the repayment of the loan amount. The Committee is further of the view that this additional interest is, in substance, an expense incurred over the tenure of the loan and it is only the payment of this interest that has been deferred till repayment of the principal amount. The Committee is, accordingly, of the view that the liability on account of the additional interest accrues over the duration of the loan even though it is payable after repayment of the principal amount.

D. Opinion

12 On the basis of the above, the Committee is of the opinion that the additional interest payable after repayment of the loan amount should be accrued over the tenure of the loan and debited to the respective profit and loss accounts and credited to the accrued liability account.

Limited Revision to Accounting Standard (AS) 13, Accounting for Investments

The Council of the Institute of Chartered Accountants of India has decided to make the following limited revision to Accounting Standard (AS) 13, Accounting for Investments:

Paragraph 2 of AS 13 is decided to be revised as under. The limited revision is shown as underlined.

"2. This Statement does not deal with:

- (a) the bases for recognition of interest, dividends and rentals earned on investments which are covered by Accounting Standard 9 on Revenue Recognition;
- (b) operating or finance leases;
- (c) investments of retirement benefit plans and life insurance enterprises; and
- (d) mutual funds and venture capital funds and/or the related asset management companies, banks and public financial institutions formed under a Central or State Government Act or so declared under the Companies Act, 1956."

The above revision comes into effect in respect of accounting periods commencing on or after 1-4-2002.