IFRS Accounting

Staff paper

Agenda reference: 5

IFRS® Interpretations Committee meeting

Date	**March 2023**
Project	**Homes and Home Loans Provided to Employees**
Topic	**Initial consideration**
Contacts	Stefano Tampubolon (stampubolon@ifrs.org) Joan Brown (jbrown@ifrs.org)

This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (Committee). This paper does not represent the views of the International Accounting Standards Board (IASB), the Committee or any individual member of the IASB or the Committee. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB® *Update*. The Committee's technical decisions are made in public and are reported in IFRIC® *Update*.

Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about how an entity accounts for:

   (a) homes it provides to its employees; and

   (b) loans it provides to its employees to enable them to buy homes.

2. The objective of this paper is:

   (a) to provide the Committee with a summary of the matter;

   (b) to present our research and analysis; and

   (c) to ask the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure

3. This paper includes:

   (a) Summary of the submission;

   (b) Findings from information request;

(c) Staff analysis; and

(d) Staff recommendation.

4. There are two appendices to this paper:

(a) Appendix A—suggested wording for the tentative agenda decision; and

(b) Appendix B—submission.

Summary of the submission

5. The submission—reproduced in Appendix B—describes two fact patterns and alternative views identified by the submitter.

Fact pattern 1: employee home ownership plans

6. An entity provides its employee with a house that the entity constructed and owns. In return, the employee:

(a) forgoes a contractual housing allowance, which the entity would have otherwise paid in cash every month; and

(b) has a proportion of his or her base salary deducted every month until the agreed price of the house has been fully repaid. The employee is not required to pay interest on the amounts outstanding.

7. The agreed price of the house is often favourable to the employee.

8. If the employee leaves employment *within* the first five years after receiving the house, the employee forfeits the house and recovers the salary deductions to date. If the employee leaves employment *after* that five-year period, the employee may choose either:

(a) to forfeit the house and recover the salary deductions to date; or

(b) to keep the house and immediately repay the outstanding balance.

9. Legal title transfers to the employee only when he or she has paid in full the agreed price for the house, either through salary deductions or by paying the outstanding balance on leaving employment.

10. The submitter asks how the entity should account for this arrangement, in particular:
    (a) when it should recognise transfer of the house to the employee—as soon as the employee starts to occupy the house, or only five years later when the employee becomes unconditionally entitled to keep the house; and
    (b) how the entity should recognise payments received and receivable from the employee before and after it recognises transfer of the house.

Fact pattern 2: employee home loans

11. An entity provides its employee with a loan to buy a house. The entity provides the loan at a below-market rate of interest, typically interest-free. The employee chooses and purchases the house—the entity never owns it.

12. The employee repays the loan through salary deductions. If the employee leaves employment for any reason at any point, the outstanding balance of the loan becomes repayable.

13. The submitter asks whether the accounting for this arrangement would differ from that in fact pattern 1.

Findings from information request

14. We sent an information request to members of the International Forum of Accounting Standard Setters, securities regulators and large accounting firms. We also made the submission available on our website.

15. The request asked:

    (a) whether employee home ownership plans and home loans like those described in the submission are common; and, if so

        (i) whether the amounts involved are often material for entities; and

        (ii) in which jurisdictions such plans and loans are common; and

    (b) how entities account for the plans and loans.

16. We received 15 responses—seven from accounting firms, seven from national standard-setters and one from an organisation representing a group of securities regulators. The responses represent informal opinions and do not necessarily reflect the official views of the respondents or their organisations.

Findings on fact pattern 1: employee home ownership plans

Are employee home ownership plans widespread and material?

17. All respondents said either that they have not seen employee home ownership plans like those described in the submission, or, if they have seen such plans, the plans are not common and the amounts involved are not material. Of those who have seen such plans:

    (a) one accounting firm said it has seen similar fact patterns to that described in the submission only in extractive industries in a few countries (Nigeria, Saudi Arabia and South Africa); and

    (b) two accounting firms said they have seen the precise fact pattern described in the submission only in Saudi Arabia.

How do entities account for employee home ownership plans?

18. Only three respondents commented on how entities account for employee home ownership plans.

19. One accounting firm and one national standard-setter (in Asia-Oceania) said the accounting for such plans depends on the relevant facts and circumstances. An entity would generally derecognise the house when it enters into a sales contract with an employee. The entity would then recognise a loan receivable in accordance with IFRS 9 and account for the below-market element of the loan as an employment benefit in the scope of IAS 19. Furthermore, the national standard-setter said the entity should also consider the requirements in IFRS 16 *Leases*.

20. Another accounting firm said it has seen diversity in how entities account for such plans, depending on when control of the house is viewed as having transferred to the employee:

    (a) View A—control transfers when the plan commences

    Under this view, the entity derecognises the house and recognises a receivable when the plan commences (as described in paragraph 19).

    (b) View B—control transfers when legal title passes to the employee

    Under this view, the entity continues to recognise the property and recognises no loan. The entity derecognises the property once the employee has fully repaid the agreed price of the house.

Findings on fact pattern 2: employee home loans

Are employee home loans common and material?

21. All respondents said either that:

    (a) they have not seen employee home loans like those described in the submission; or

    (b) although they have seen such loans, they have not seen them often and the amounts involved are not material.

22. Of the respondents who have seen such loans:

    (a) one accounting firm said the loans are provided by entities in banking and extractive industries in several countries in Africa, Asia, Central America, and Europe. The firm said the loans are becoming less frequent in these jurisdictions.

    (b) one organisation representing a group of security regulators said two regulators have seen home loans with preferential interest rates in their jurisdictions.

    (c) one national standard-setter (in Asia-Oceania) said banks in its jurisdiction offer loans to their employees but with varying terms and conditions. Another national standard-setter (also in Asia-Oceania) said fact patterns involving other types of assets (such as motor vehicles) might be more common than that described in the submission.

23. A few respondents said loans of the type described in the submission are common in some jurisdictions but the amounts are not material:

    (a) one national standard-setter (in Asia-Oceania) said such loans are common in its jurisdiction. Another national standard-setter (in Europe) and two accounting firms said such loans are common in the banking industry.

    (b) one accounting firm said such loans are common in Saudi Arabia and South Africa.

How do entities account for employee home loans?

24. Only five respondents commented on how entities account for loans they provide to employees at below-market interest rates.

25. Two accounting firms and one national standard-setter (in Asia-Oceania) said they have observed no diversity in how entities account for such loans. These respondents said:

(a) the loan is accounted for as a financial asset within the scope of IFRS 9 *Financial Instruments*. It is initially measured at fair value. It is subsequently measured at amortised cost and subject to expected credit loss testing.

(b) the difference between the fair value and the nominal amount of the loan is recognised as a prepaid employee benefit and amortised over the shorter of (i) the expected employment term and (ii) the loan term. If the employee resigns before fully repaying the loan, the prepaid employee benefit balance is expensed immediately.

26. The only diversity reported by respondents related to income statement presentation. An accounting firm said that, on the rare occasions it had seen employee home loans in the past, it had observed diversity in how entities presented the below-market element of the loans in the income statement—some entities recognised it as a reduction in interest income and others as an employee expense.

27. The organisation representing a group of securities regulators said one of its regulators (that has seen employee loans arrangements) has observed entities initially measuring loans to employees at their face value, without discounting for the preferential interest rates. The rationale for this practice is that preferential interest rates are common market practice for loans to employees. However, the difference between the face value and fair value of the loans is not material.

Staff analysis

Should the Committee add a standard-setting project to the work plan?

28. Paragraph 5.16 of the *Due Process Handbook* sets out the criteria the Committee considers when determining whether to add a standard-setting project to the work plan. One criterion, included in sub-paragraph 5.16(a), is that 'the matter has widespread effect and has, or is expected to have, a material effect on those affected'.

29. The responses to our information request (as summarised in paragraphs 17–27 of this paper) indicate that this criterion is not met. The responses indicate that neither of the fact patterns described in the submission is widespread, and that even when the fact patterns do arise, the amounts involved are not material.

Staff recommendation

30. Based on our assessment of the work plan criteria in paragraph 5.16 of the *Due Process Handbook* (as discussed in paragraphs 28–29), we recommend that the Committee does not add a standard-setting project to the work plan. We recommend the Committee instead publishes a tentative agenda decision that explains its reasons for not adding a standard-setting project.

31. Appendix A to this paper suggests wording for the tentative agenda decision.

Questions for the Committee
1. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan? 2. Does the Committee have any comments on the wording of the tentative agenda decision suggested in Appendix A to this paper?

Appendix A—suggested wording for the tentative agenda decision

Homes and Home Loans Provided to Employees

The Committee received a request about how an entity accounts for homes and loans to buy homes provided to its employees.

Fact pattern 1: employee home ownership plans

An entity provides its employee with a house that the entity constructed and owns. In return, the employee has a proportion of his or her base salary deducted every month until the agreed price of the house has been fully repaid.

If the employee leaves employment *within* the first five years after receiving the house, the employee forfeits the house and recovers the salary deductions to date. If the employee leaves employment *after* that five-year period, the employee may choose either:

(a) to forfeit the house and recover the salary deductions to date; or

(b) to keep the house and immediately repay the outstanding balance.

Legal title transfers to the employee only when he or she has paid in full the agreed price for the house.

The request asked how the entity should account for this arrangement—in particular, when it should recognise transfer of the house to the employee, and the accounting before and after the transfer.

Fact pattern 2: employee home loans

An entity provides its employee with a loan to buy a house, which the employee chooses and purchases and the entity does not own. The entity provides the loan at a below-market rate of interest, typically interest-free. The employee repays the loan through salary deductions. If the employee leaves employment for any reason at any point, the outstanding balance of the loan becomes repayable.

The request asked how the entity should account for this arrangement—in particular, whether the loan is:

(a) a prepaid employee benefit within the scope of IAS 19 *Employee Benefits*; or

(b) a financial asset within the scope of IFRS 9 *Financial Instruments*, with the below-market element loan accounted for as prepaid employee benefit by applying IAS 19.

Findings

Evidence gathered by the Committee [to date] indicated that the matters described in the request are not widespread, and that when the matters do arise, the amounts involved are not material.

Conclusion

Based on the evidence it gathered, the Committee concluded that the matters described in the request do not have widespread effect and do not have (and are not expected to have) a material effect on those affected. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—submission

B1. We have reproduced the submission below, and in doing so deleted details that would identify the submitter of the request.

Suggested topic for Interpretations Committee agenda:

Provision of homes and home loans to employees

…

It is relatively common in our market for entities to provide their employees with a house constructed by the entity, or a loan to buy a house of their own choosing. Whether the employer provides the house or a loan, the employee pays off his share of the cost of the house, or the loan principal, through deductions from salary over many years of service and interest is typically not charged. Should he resign, under both types of arrangement, he is usually required to pay off the remaining balance due in full, or otherwise forfeit the house. A number of accounting issues have arisen with respect to these arrangements, primarily relating to the appropriate accounting standard to apply. We do not believe that IFRS is sufficiently clear whether IAS 19 or IFRS 9 should be applied when cash or other assets are provided to an employee in advance of service.

We have set out in Sections A & B example fact patterns and associated questions. We would be grateful to the Committee for its consideration of these questions.

…

Section A – Employee home ownership plan example

Fact Pattern

Employees invited to participate in the home ownership plan are immediately provided with a house constructed and owned by the entity. In return, the employee agrees that he will not receive his contractual housing allowance as part of his salary (which would otherwise have been paid to him monthly in cash), and also agrees to surrender 17% of his base salary every month until the agreed value of the house has been repaid. No interest is charged. Once the

balance has been fully repaid through salary deductions, the employee becomes the legal owner of the house.

If the employee resigns within the first 5 years after receiving his home, he forfeits the home and is paid out the 17% of base pay previously withheld. He does not recover the housing allowance. If the employee resigns after 5 years but before the balance is paid off, the employee has 2 choices: (i) he can forfeit the house and recover the 17% of base pay previously withheld, or (ii) keep the house and immediately pay off the outstanding balance.

Due to the fact that the outstanding balance is reduced each month by the housing allowance and 17% of base pay (and does not bear interest), it is almost always in the employee's interest to keep the house and pay off the balance. Also, the initial agreed price of the home is often favourable to the employee, further incentivising him to keep the house.

Nothing in the home ownership contract forces the entity to continue to employ the employee. Should he be terminated, the same terms apply as if the employee had resigned.

Questions for the Committee

1. What is the nature of the arrangement during the first 5 years of the employee's participation in the programme? Has the house been transferred on day 1 and, if not, what is the accounting during the initial period?

2. What is the nature of the arrangement once control of the house has been transferred to the employee? Is it a prepaid short-term employee benefit under IAS 19 or a financial asset under IFRS 9?

Analysis – Question 1

View A: House transfers after 5 years – IAS 19 accounting during that period

The house remains the PPE of the entity at the point that the employee first takes up residence. The IAS 16 derecognition guidance in paragraph 69 cross-refers to IFRS 15. Analysing transfer of control under IFRS 15 para 38, the employee is not obligated to pay for the asset and does not have legal title, while risks and rewards are somewhat shared as the

employee has upside rewards but is protected from downside risk due to his ability to resign and hand back the house. Similarly, although the employee has accepted the asset for now, he still has the ability to change his mind by resigning and handing back the house. Furthermore, IFRS 15 para B66 states that sales with a call option do not result in a transfer of control. No probability assessment applies; the simple existence of a call option prevents control transfer. The ability of the entity to fire the employee and recover the house can be viewed as a call option over the house. It is difficult to argue that the employee controls the house while his ability to continue to possess it is entirely contingent on future service.

As the employee does not initially receive the house, there is no initial transfer to the employee. Rather, as the employee provides his service he earns the right to either receive a house or the cumulative 17% of base pay that is initially withheld. Should the employee ultimately receive a house, he will receive this while still in service making this option an other long-term employee benefit per IAS 19 para 8. However, if the employee leaves, he may ultimately be paid the cumulative 17% of base pay previously withheld at the point his employment ceases; this would be a post-employment benefit per the IAS 19 para 8 definitions.

IAS 19 provides no guidance on the accounting for mutually exclusive awards, but it would seem reasonable for the entity to make an estimate of the proportion of employees who will receive each type of benefit and account for the two liabilities accordingly.

View B: House transfers on day 1

Despite technically being able to fire the employee and recover the house, the entity would not reasonably fire a good employee simply to recover the house. The recovery of the house is a potential by-product of the termination of the employment relationship and not a separate decision made by the entity contemplated in IFRS 15 para B66. Consequently, this aspect of the arrangement should not be viewed as a call option. Absent there being a call option it would be reasonable to conclude that control has transferred because he does bear some of the risks and rewards, he has physical possession, and the fact he currently lives in it indicates acceptance.

While a minority of houses might ultimately be returned to the entity, these would either be as the result of (i) an employee put at a price lower than the original purchase price which at inception the employee does not have a significant economic incentive to exercise (IFRS 15 para B72), or (ii) the unforeseen departure of the employee during the first 5 years. With respect to (i), such a put does not prevent transfer of control and similar IFRS 15 arrangements are treated as sales with a right of return. A similar analogy to sales with a right of return might also be reasonable for employees who leave within the first 5 years. At inception the intention was to permanently transfer the house to the employee but unforeseen circumstances ultimately led to cessation of employment sooner than expected and a return of the house. Any return of the house is unlikely, and incidental to the more significant employment relationship. IFRS 15 provides no guidance on control transfer when a return is incidental to another arrangement.

As a result of there being no call or put option guidance blocking transfer of control, the employee is deemed to control the house from day 1. The employee has physical possession of the house, is economically compelled to provide further service to obtain the house at a good price (i.e. pay for it), while he also has the upside rewards created by the beneficial pricing and payment plan with little downside risk. The transfer of legal title, is withheld only to secure the entity's right to receive the purchase price from the employee.

The house is transferred to the employee on day 1 so the accounting for the arrangement is the same in the first 5 years as it is subsequently (see Question 2).

Analysis – Question 2

View A: IAS 19 Short-term employee benefit

Once the house meets the criteria for derecognition in IAS 16, the cost of the asset (net of any liability recorded under Q1 View A if appropriate) is reclassified at no gain no loss into a prepaid short-term employee benefit. The arrangement is an employee benefit because the house is provided in exchange for service. An equivalent employee who was not part of the programme would receive more cash, evidencing the barter of house for service. Despite the long-term nature of the arrangement, the fact that the entity prepays the benefit means that it

counterintuitively falls within the definition of short-term employee benefits in IAS 19 para 8.

The arrangement is not a financial asset to the entity because it does not have the contractual right to receive cash per IAS 32 para 11. The employee may pay off the whole debt through the provision of employee services. Furthermore, the arrangement meets the definition of an employee benefit in IAS 19 para 8 and consequently is scoped out of the financial instruments guidance by IFRS 9 para 2.1(c).

In accordance with IAS 19 para 11 an entity does not account for the time-value of money in short-term employee benefits and recognises an expense for the amount of benefit expected to be paid for employee service in each year. This will require the entity to ascertain how long the employee is expected to remain in service, the extent to which employees are expected to take the house compared to the 17% of historic base pay, and allocate the expected net cost over the expected period of service on an undiscounted basis.

View B: Combination of IFRS 9 & IAS 19

While IAS 19 does take precedence over IFRS 9 for the reasons set out in View A, the employee benefit is not the full value transferred to the employee, rather it is only the off-market element of the arrangement that falls in scope of IAS 19. Once the PPE is derecognised, the value of the property is highly likely in most normal market conditions to significantly exceed the present value of the amount outstanding due to there not being any interest charged. While technically the employee could end up putting the house back to the entity, this is very unlikely and would be counter to the employee's economic interests in substantially all cases. For this reason, the amount outstanding should be viewed as a financial instrument with the house being collateral. There are certain cash flows that the employee must settle either from his salary or other sources, and there is no substantive optionality in the arrangement. Only the difference between the fair value of the receivable and the cost of the house should be treated as an employee benefit under IAS 19, the remaining portion is an at-the-market lending arrangement.

The fact that employees may leave before the house is fully paid off means that they could end up paying significantly more than the present value of the remaining cash flows. In such circumstances the employee must pay back the full amount of legal principal outstanding, not the discounted present value. This contractual feature in the loan agreement potentially changes the timing of the contractual cash flows per IFRS 9 para B4.1.10, the prepayment price does not approximate principal and outstanding interest per IFRS 9 para B4.1.11(b) (see IFRS 9 para B4.1.7B for the definition of principal), and the fair value of the prepayment feature at initial recognition is unlikely to be insignificant per IFRS 9 para B4.1.12(c). As such, the receivable would not pass SPPI and would be carried at FVPL.

Section B – Employee home loan example

Fact Pattern

Employee home loan arrangements bear many similarities to employee home ownership programmes, but also some differences. The off-market loan, typically interest-free, is provided on day 1 so that the employee can buy the house. In these cases, the house is chosen by the employee and not provided by the entity. However, similar scoping issues arise with respect to the asset on the balance sheet.

The employee typically makes a down payment similar to regular mortgage loans. Should the employee leave employment for any reason, the full legal principal amount of the loan is repayable. Otherwise, amounts are deducted from salary until the balance is eliminated. Also in similar fashion to the home ownership programmes discussed in Section A, the value of the property is substantially higher than the value of the payments that the employee must make (particularly once the time value of money is considered). Consequently, there is no substantive optionality in the arrangement such that the employee might choose to avoid paying the balance and hand over the house to the entity.

Despite the similarities with programmes where actual houses are provided by the employer, in practice some entities account for home loan plans differently to home ownership plans

(once the asset has been transferred). Some entities account for cash loans as financial assets while home ownership plans are treated as prepaid employee benefits.

Questions for the Committee

3. Does the form of the asset given to the employee (i.e. house or cash) impact the accounting for the programme?

Analysis – Question 3

View A: Yes

Although the method of repayment is the same in both cases (service and/or cash on resignation), an assessment of the substance cannot ignore the legal form of the agreements. One is intended to be the exchange of a house for service, while the other is a loan in legal form. IAS 32 para 18 states that the substance of a financial instrument and its legal form are commonly consistent. In the case of a home loan, a legal debt exists and the employer requires it to be repaid. The employer is indifferent where the cash comes from and it is simply a matter of convenience that it is offset against salary. Recovering the cash through a convenient offset doesn't change the substance that a loan is a financial instrument and different from other employee benefits such as housing.

View B: No

In the case of both employee home ownership and home loan plans, the scoping considerations are the same once the employee has control of the asset because the substance is the same. In both cases the employee is able to pay off the outstanding balance entirely through future service, and should he resign he is strongly incentivised to keep the house and pay off the remaining balance to the employer. In both cases a decision has to be made as to whether this is entirely a prepaid IAS 19 employee benefit, or a financial asset with a smaller employee benefit related only to the off-market element. Nothing in the scoping sections of IAS 19 or IAS 32/IFRS 9 indicates that the form of the consideration paid in advance impacts whether employee benefit or financial instrument accounting applies.