

Disclosure of Director's Loan

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Introduction

XYZ (Pvt) Ltd is a limited liability company which is engaged producing, importing and hiring films all over the country. They are distributing films using their own circuit of film halls and other circuits, and providing space in their film halls to distribute films of other film circuits. During the financial reporting period of 2013/2014 company has provided a loan for a Managing Director of the company for the purpose of producing, printing and promoting a particular film. The loan has been provided legally with film loan agreement within the parties of Film producer and Film Distributor.

Discussion of the Issue

When it comes to consideration, initially the agreement is between the film producer and film distributor to provide a loan for the purpose of production, print, and publicity expenses of the film. But when it analyse in depth, the transaction is between the company and its managing director. In that point of view, we have to consider the companies act no 7 of 2007 to analyse the situation.

In accordance with subsection 1 of section 217 of company act no 7 of 2007,

“a. A company cannot give loans to one of its directors or a director of a related company.

b. Enter into any guarantee or the provision of security in connection with a loan made by any person to a director of the company or of a related company.”

And further it describes in subsection 3 of section 217,

“Where any loan is given in contravention of the provisions of subsection (1), the loan shall be voidable at the option of the company and the loan shall be immediately repayable upon being avoided by the company, notwithstanding the terms of any agreement relating to the loan”

And in subsection 4 it says,

“Where a transaction other than giving a loan to a director is entered into by a company in contravention of subsection (1)—

(a) the director shall be liable to indemnify the company for any loss or damage resulting from the transaction;”

However in this case there is no any interest or any fee is charged by the company even for time value of money.

However the act does not prevent a company from giving a loan as per subsection 2,

- (a) giving a loan to a director, where the aggregate of the amounts advanced to the director by the company does not exceed twenty-five thousand rupees or such higher sum as may be prescribed by the Minister from time to time, on the recommendation of the Advisory Commission constituted under Part XIX of this Act ;*
- (b) giving a loan to a related company or entering into a guarantee or providing security in connection with a loan given by any person to a related company;*
- (c) providing a director with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him to perform his duties as an officer of the company; or*
- (d) giving a loan in the ordinary course of the business of lending money, where that business is carried on by the company*

Subsection 5 of the same section describes that,

“Where a company fails to comply with the provisions of subsection (1) —

(a) The company shall be guilty of an offence and be liable on conviction to a fine not exceeding two hundred thousand rupees; and

(b) Every director of the company who authorises or permits the company to enter into the relevant transaction, shall be guilty of an offence and be liable on conviction to a fine not exceeding one hundred thousand rupees”

And when we consider on LKAS 24 – Related Party Disclosures, as per the standard a related party is,

“A member of key management personnel of the reporting entity.....”

Then this manager is a related party of the company. So this transaction should be treated as related party transactions. As per paragraph 19 of the standard, it describes that

“The classification of amounts payable to, and receivable from, related parties in the different categories as required in paragraph 18 is an extension of the disclosure requirement in LKAS 1 Presentation of financial statements for information to be presented either in the statement of financial statement of financial position or in the notes”

Implication of the Issue

According to the above situation, directors loan transaction considers as violation of companies act no 7 of 2007. Hence, the director has an obligation to bear the damages and losses which are faced by the company.

However, there is contradictory with Companies Act no 7 of 2007 and LKAS 24 related party disclosure standard. In accordance with companies act, companies cannot provide loans to directors. But as per LKAS 24 companies should disclose loans which have been given to directors. So if cannot provide why there is a standard to disclosure.

Financially, the company is waiting for reimbursing the loan and earning an income through the film until film launched and also blocking money for that film in higher amount.

Conclusion and Recommendation

Company should avoid this kind of transactions with directors and directors should be liable for the damages and losses

The transactions should be shown in accounts in separately and should be disclosed as notes.