Possibility of long term loan impairment

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Introduction

The Modern Techno Lanka Private Limited is a large scale company which operates in IT based business solutions, software development, buying and selling of hardware & related services while being the parent of three subsidiaries and having one associate company. Their main operating income is based on the software development and branches are located in foreign countries.

The Company has given a loan to its subsidiary company according to the contractual terms with a loan agreement. Based on current information and events, it is probable that the parent will be unable to collect all amounts due from the subsidiary according to the contractual terms written in the loan agreement due to the significant financial problem and significant shortfalls of the borrower.

Discussion of the Issue

Generally, a loan in which a borrower is making principal and interest payments according to the agreement is considered as a performing loan and is not impaired , even an insignificant delay or insignificant shortfall in amount of payments does not result in the loan being impaired. Nevertheless if the delay or shortfall amount is significant, the loan is likely to be impaired.

Therefore at the end of the each reporting period the company should assess whether there is objective evidence for the impairment loss of the financial assets which are measured at cost or amortized cost. However, the company had not recognized an impairment loss on the long term loan receivable, though there were objective evidences to identify the impairment loss on financial assets. They had recognized the loan receivable amount as it impacts to the financial statements. Therefore it is essential to identify the impairment loss on long term loans receivable which was granted to its subsidiary company.

Conclusions and Recommendations

Due to the recognition of loan receivable amount as it is in the financial statements, the company's financial position may be over stated due to the unrecoverable loan receivables and the company Return on Assets (ROA) may be over stated , because of that the company's financial statements may not be reflect the true and fair view. Similarly there may be the substance over form of the financial statements and as a result of these it will lead to lose the reliability and relevance of the financial statements and the decisions made based on such financial statements also can be mislead.

Application of LKAS 39 – "Financial Instruments: Recognition and Measurement"

When the financial asset is recognized to the financial statements of the company, initially measured it at the transaction price. When the arrangement constitutes financing transactions the company should measures the financial asset at

the present value of the future cash flows discounted at a market rate of interest. Furthermore the company has to measure impairment loss on the financial asset at the end of the each reporting period as per the LKAS 39 – "Financial Instruments: Recognition and Measurement".

Impairment Loss should be charged to the Statement of Comprehensive Income and the Recoverable Amount of the loan should be recognized as the Asset to the Statement of Financial Position.

Carrying amount of the Loan	xxxxx
Recoverable amount	(xxx)
Impairment Loss	xxx