

How to transfer heavy losses while smiling to the shareholder

A.M.M.S Abeykoon & M.W. Madurapperuma
mabeykoon@kpmg.com&wasanthi@kln.ac.lk

Introduction

Alpha (Pvt) Ltd is the parent of Beta Finance PLC which was listed in CSE. During the audit it was noted that Alpha (Pvt) Ltd has agreed to purchase debtors of Beta PLC to whom Beta has lent Financial Assistance. Later Alpha has entered into an agreement with Beta PLC to pay the full outstanding liability of the debtor where Beta PLC agreed to remit all payments made by the said debtor to Alpha on a regular basis. The said debtor has been fully written off in the books of Beta PLC, prior to the debt transfer. However it was noted that these debtors are currently non-performing and as at the reporting date Alpha has agreed to purchase nonmoving debtor balance amounting 120Mn and Beta Finance PLC has recognized this amount in their Statement of Financial Position as a receivable from the Alpha.

Discussion of the Issue

According to the Finance Companies (Fixed Assets) Direction No. 04 following to be satisfied in order to transfer assets between related parties. This Direction may be cited as the Finance Companies (Transfer of Assets) Direction No. 4 of 1991 and shall apply to every finance company registered in terms of section 2 of the Finance Companies Act, No.78 of 1988 and shall come into operation with immediate effect.

- No finance company shall transfer any of its assets of a value of more than Rupees Fifty Thousand (Rs.50,000/-) at a price less than the prevailing market value without the prior

permission of the Central Bank of Sri Lanka to any person or body of persons, corporate or unincorporated.

- For the purpose of paragraph 3 the word "prevailing market value" should be as determined by a licensed valuer.

What is Special Purpose Vehicle

Further this is an indication that Alpha is a Special Purpose Vehicle (SPV) that used by the Finance company for the transfer of unused losses from the company and demonstrates a clean image about the company. According to the Standard Interpretation Committee SIC 12 (01), an entity may be created to accomplish a narrow and well-defined objective. This is called a Special Purpose Entity (SPE). According to the SIC 12 (08), an SPE should be consolidated when the substance of the relationship between an entity and the SPE indicates that the SPE is controlled by that entity.

Considering the debtor assignment, it reflects that the activities of Alpha, in substance, are being conducted (Debtors Collection) on behalf of the Beta Finance PLC, therefore which is directly created to satisfy specific business needs of Beta Finance PLC.

Conclusions and Recommendations

To become a special purpose entity, Alpha (Pvt) Ltd would have been established only for the purpose of the transaction made by the Beta PLC. Since the Beta Finance PLC is a subsidiary of Alpha (Pvt) Ltd the controlling power could not be changed/transferred simply because of this intercompany transaction and hence the Group financial Statements can be misled. The "prevailing market value" of the debtor should be as

determined by a licensed valuer apart from the Director's valuation. DoA

Recommendation

The company should be adhered to the rules given by the regulatory Bodies and the company should be in lined with the acceptable best practices of accounting standards.