Loan outstanding Vs Impairment

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Introduction

"Protection PLC" is providing five major categories of staff loans to their employees. But they do not have a process in place to provide for impairment of the staff loan. But According to the LKAS 39 Financial Instruments recognition and measurement, at each balance sheet date the entity have to assess whether there are objective evidences of impairment. Still they couldn't do any impairment. But there are some impairment indications in staff loans.

Discussion of the issue

At each reporting date, Protection PLC should assess whether there are objective evidences of impairment of staff loans based on following indicators.

1. Obligator facing significant financial difficulties
2. Default or breach of the loan contract
3. Resigning of the employee without settling the outstanding loan balance
4. Non Availability of an active market for the asset secured against the loan
5. Measurable decrease in the estimated future cash flows of the security

The standard says that "A financial asset or group of financial assets is impaired and impairment losses are incurred if, only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated."

Finally the issue affects to the profit attributable to the shareholders. Further it wouldn't be a fair presentation of financial information and not comply with the financial framework.

Conclusions and Recommendations

Since the nature of each category is different from others, the entity has to propose provisioning for those loans with considering every category separately.

Eg: Motor Bike loans, Laptop Loans etc.

If there are any indications recognized under the impairment test, the entity has to provide necessary provision in line with the provisioning guidelines of LKAS 39 Financial Instruments recognition and measurement. Basically it should be based on the security of each loan category. Because of the loan categories are different from each other.