

Director's loan classification as equity instrument

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Introduction

SIGMA Private Ltd is recognized as top manufacturing giant for garment manufacturing and wet processing in Sri Lanka. Its network extends across Sri Lanka and overseas with more than 8,000 employees working under the company. The privately owned BOI company still stands as a one of the most & reliable name in the industry. With the expansion of business activities, the company required more capital than previous years.

Discussion of the issue

A Director of SIGMA (Pvt) Ltd provides interest free loan to the company as remedy of capital requirement of the business. There is no any agreement between company and the director of SIGMA regarding re- payment of loan and loan interest. Also subsequently company has an idea to make share issue and they wish to convert that loan amount to shares.

Recommendations & Conclusions

Financial Statement of SIGMA shows that the loan amount recognized as a "long term liability" of the company. Although as a professional accountants this issue brings some accounting dilemma regarding followings,

- Some financial instruments that meet the basic definition of a liability are classified as equity if debt

instrument not satisfy the specific recognition criteria mention in Section 11, SLFRS for SME. Accordingly, a debt instrument that required satisfying the conditions given below ,

Returns to the holder are;

- Fixed Amount
- Fixed rate of return Over the life of the instrument
- A Variable return that throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate.
- Some combination of such fixed rate and variable rate. Provided that both the fixed and variable rates are positive. For fixed & variable rate interest returns, Interest is calculated by multiplying the rate for the applicable period by the principal amount outstanding during the period.
- Arise adjusting event after the reporting period

Subsequent share issue of the company provides a strong evidence of condition that existed at the end of reporting period. Therefore according to the LKAS 10, that share issue classify as an adjusting event.

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decision. Although financial statement Information of SIGMA (Pvt) Ltd not comply qualitative characteristics the t should be complied by entities, due to their error classification of director loans. Therefore, the interest free loan amounting Rs. 50 Million provided by the Director, is not satisfied conditions mentions

in section 11, SLFRS for SME. Therefore the Director's loan should be classified as an Equity Instrument.