



Article topic: Financial Reporting

Directors Loan Accounts: Disclosure Issues

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The implementation of the Companies Act 2006 (CA 06) and specifically Section 413 has not been short of controversy since its arrival. This area of the Companies Act has been extremely poorly drafted and there seems to be an understandable amount of confusion concerning the disclosure requirements contained within Section 413.

This article will look at the issue concerning loans to directors, specifically for companies who apply FRSE and offer a possible 'common sense' approach to disclosure of advances to directors.

Section 197(1) of CA 06 does make a general prohibition on loans to directors and also related guarantees or provisions of security where the approval of the shareholders is not obtained. However, such approval is not required for 'minor' loans i.e. if the aggregate value of the transaction(s) does not exceed £10,000, and companies are not prohibited under CA 06 to make such loans.

If advances are made to directors which exceed £10,000 then member approval must be obtained which can be in the form of a board resolution.

Advances to Directors

The problem child is advances to directors and what to disclose. S413 requires the following details to be disclosed in respect of advances:

- a. its amount;
- b. an indication of the interest rate;
- c. its main conditions; and
- d. any amounts repaid.

In addition, the notes to the financial statements must also disclose:

- the total amounts stated in (a); and
- the total amounts stated in (d).

Disclosure is also required in respect of:

- Guarantees of any kind entered into by the company on behalf of the directors, which disclose:
 - the main terms;
 - the amount of the maximum liability that may be incurred by the company (or its subsidiary); and
 - any amount paid and any liability incurred by the company (or its subsidiary) for the purpose of fulfilling the guarantee (which must also include any loss incurred by reason of enforcement of the guarantee).

The disclosures in (a) to (d) are the most controversial and accountants (particularly those dealing with FRSSE companies) are confused as to how to make this disclosure. For clients who have overdrawn directors current accounts, making disclosure of each individual entry is considered ludicrous, and certainly clients whose loan accounts are overdrawn do not look favourably upon such disclosure.

This particular area of the Companies Act is anticipated to be amended because its drafting has not taken into consideration the onerous disclosure requirements which it currently compels to ensure the financial statements give a true and fair view.

Under the old 1985 Act, where a directors loan account was overdrawn it was sufficient to disclose the opening balance at the start of the period, the closing balance at the end of the period and the maximum balance outstanding during the period. Of course, this is no longer the case under S413 and those who are 'for' section 413 cite the fact that the company and the director are two distinct bodies and the directors should not be using the company bank account as if it were their own private bank account. Arguably this fact has some merit.

However, it would seem accountants in practice (indeed certainly those who I have met during lectures) want a more 'common sense' approach to dealing with such disclosure. One accountant who I met said one of their clients who had an overdrawn directors loan account made the disclosures look like a shopping list!

A possible solution

Financial statements must be prepared that give a true and fair view and this concept has always been (and always will be) the case. Auditors of companies who are mandated to have a statutory audit, or choose to have a statutory audit, will form an overall opinion as to whether the financial statements give a true and fair view, or not.

In a lot of cases, advances to directors consist of several items which make up an overdrawn balance as at the end of a reporting period. However, consider a company that simply makes a £50,000 advance to the director for the purpose of a house purchase. In this case, the related party disclosure could be as simple as:

During the period, the company made a short-term loan to Mr Director amounting to £50,000 for the purposes of a house purchase. Interest at the rate of 7.5% per annum is payable half yearly and the loan is repayable on 31 December 20XX.

In cases where the directors loan account consists of several transactions, a possible solution could be to determine the materiality of advances and repayments; aggregate the immaterial transactions and disclose separately the material items, essentially using the following as a 'template' reconciliation:

Opening balance		X
Plus:		
Loans made in the period (advances)	X	
Private expenditure in the period	<u>X</u>	X
Less:		
Undrawn remuneration	(X)	
Loan repayments in the period	(X)	
Dividends declared in the period	<u>(X)</u>	<u>(X)</u>
Closing balance		<u>X</u>

Where items of expenditure or repayment are considered to be material to the financial statements, or are dissimilar in terms of those expenses which have been aggregated then these should be disclosed separately as a note. It might also be worthwhile disclosing the maximum amounts which were overdrawn during the year. Whatever disclosure is made in the full financial statements must also be made in the abbreviated financial statements given that this is a Companies Act requirement.

Audited financial statements

If financial statements are audited and the directors loan accounts are overdrawn, the auditors must be satisfied that the disclosure contained within the financial statements give a true and fair view, so the above 'template' is persuasive rather than prescriptive.

Credit balances and withdrawals

Indeed, any withdrawals made by the director from bona fide credit balances on their loan accounts cannot be constituted as an 'advance' because these are simply repayments of funds previously invested in the company by the director and should not be treated as an advance.

Conclusion

The poorly drafted S 413 has brought a significant amount of controversy (and confusion), and indeed may have aggrieved some clients of practitioners where they have disclosed each and every transaction that results in an overdrawn position at the end of a reporting period. I am sure a common sense approach would be welcomed by practitioners and it would be interesting to hear of others' views on how they have applied the provisions in S 413 since the implementation of CA 06.

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