

**REPORT OF AUDITORS ON THE DIRECTORS' STATEMENT OF SOLVENCY –  
AS PER SECTION 56(2) OF COMPANIES ACT NO. 7 OF 2007**

**Companies Act Requirements**

**Section 56(2) - Distribution**

*The board of a company may authorise a distribution at such time and in such amount as it considers appropriate, where it is satisfied that the company will, immediately after the distribution is made satisfy the solvency test, provided that such board obtains a certificate of solvency from the auditors.*

**Section 57(1) – Solvency Test**

*A company shall be deemed to have satisfied the solvency test, if –*

- (a) It is able to pay its debts as they become due in the normal course of business; and*
- (b) The value of the company's assets is greater than –
  - i. The value of its liabilities; and*
  - ii. The company's stated capital**

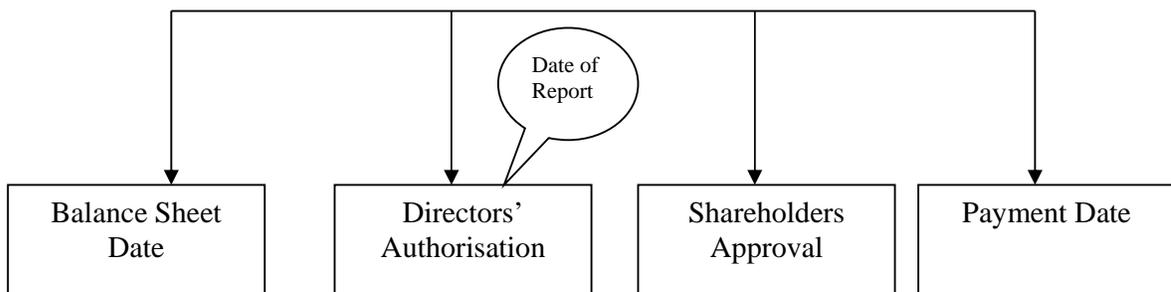
**Section 57(2)**

*In determining whether a company satisfies the solvency test, the board –*

- (a) Shall take into account the most recent financial statements of the company prepared in accordance with Section 151 of the Act;*
- (b) Shall take into account circumstances the directors know or ought to know which affect the value of the company's assets and liabilities;*
- (c) May take into account a fair valuation or other method of assessing the value of assets and liabilities.*

**Date on which the opinion is required**

- On the date **directors authorise** the recommendation of dividends



## **Procedures to be generally adopted by auditors for final dividends**

- Obtain most recent financial statements in accordance with Section 151 of the Act (the latest audited financial statements).

*Financial statements mean –*

*(a) balance sheet of the company as at the balance sheet date; and*

*(b) In the case of –*

- i. A company trading for profit, profit & loss statement for the company in relation to the accounting period ending at the balance sheet date; and*
- ii. A company not trading for profit, an income & expenditure statement for the company in relation to the accounting period ending at the balance sheet date,*  
*together with any notes or documents giving information relating to the balance sheet or statement.*

- Identify circumstances that directors know or ought to know, which affects the value of assets and liabilities of the company, e.g. Impairment of assets.

*“An auditor is expected to perform procedures designed to obtain sufficient appropriate audit evidence that all events up to the date of the Auditors Report (This means the Statutory Audit Report) that may require adjustment of, or disclosure in, the financial statements have been identified. (SLAuS 20 Subsequent Events). In providing the Report of Auditors on the Directors’ Statement of Solvency and auditor is expected to perform this procedure up to the date of authorisation of the recommendation of dividends by the Board. This is to ensure that the company has adequate net assets to issue / pay dividends after taking into account any significant impairment to assets, which were disclosed as at the balance sheet date and have occurred since Balance sheet date upto the date of authorisation of the recommendation of dividends .*

- Review cash and credit lines that may be used to pay out dividends.

This is to ensure that the company is able to pay its debts as they become due in the normal course of business.

## **Procedures to be generally adopted by auditors for Interim dividends**

The directors should prepare the Directors Statement based on the latest financial statements prepared in accordance with Section 151 of the Act.

If the period between the balance sheet date and date of recommending the dividends is more than 6 months, the auditor needs to perform a review/ audit on the financial statement to be used by the directors to prepare their statements , to ensure that those financial statements re have been prepared in accordance with Section 151 of the Act.

If the period between the balance sheet date and date of recommending the dividends is within 6 months, the auditor needs to perform the procedures set out above for final dividends

## **Report of Auditors and Opinion**

Considering the fact that the auditor does not assume significant additional risks and after considering the nature of the work to be performed, it is concluded that a **SLAPS 1 (Special Purpose Audit Engagement) opinion** shall be provided.

## FREQUENTLY ASKED QUESTIONS

**1. Do all auditors have to issue a report on the Directors' Statement of Solvency?**

Answer: No. Private companies acting with unanimous shareholder approval are exempt from the following provisions:

Section 52	Consideration for issue of shares
Section 53	Pre-emptive rights to new issues
<b>Section 56</b>	<b>Distribution</b>
Section 60	Dividends
Section 61	Recovery of distributions
Section 64	Purchase of own shares
Section 70	Restrictions on giving financial assistance
Section 90	Exercise of powers reserved to shareholders
Section 92 (1)(b)	Powers exercised by special resolution
Section 99	Alteration of shareholder rights
Section 185	Major transactions
Section 192	Disclosure of interests
Section 193	Avoidance of transactions
Section 216	Remunerations and other benefits
Section 217	Restriction on loans to directors
Section 218	Indemnity and insurance

This implies that as per the Second Schedule provision, the Directors' Statement of Solvency is not required under the above circumstances.

However, under Section 31(3), it states, "*Where a distribution is made by a company under subsection 2 and as a consequence of making that distribution the company fails to satisfy the solvency test, such distribution shall be deemed not to have been made validly*".

This means that, a private company may opt not to prepare the Directors' Statement of Solvency at the point of distribution, when there is unanimous shareholder approval. However, if later they fail to satisfy the solvency test, such distribution will not be considered valid. Further, if such company opts to prepare a Directors' Statement of Solvency, the auditor may be required to provide the Report of Auditors on this Directors' Statement of Solvency.

**2. Identify the three parties involved, who are required in issuing a SLAPS 1 opinion.**

Answer: The three parties are: (1) The auditor, (2) The directors, and (3) The law (Law represents the parties intended to be protected by law)

**3. The level of assurance provided.**

Answer: High but not absolute. Thus a positive assurance is provided.

**4. Does the auditor provide an unqualified opinion in all circumstances?**

Answer: No. If the auditor is not satisfied with the Directors' Statement of Solvency e.g. if the Statement had been based on the audited financial statements of the previous financial year, an auditor may modify the opinion to that effect.

Another option would be not to accept such assignment, as the company is not in a position to provide 'most recent financial statements', as required by Section 57(2) of the Companies Act.

**5. Is the auditor expected to provide a 'futuristic' opinion?**

Answer: No.

As per section 57 (1) of the Act., a company is deemed solvent should they satisfy the following conditions;

- It is able to pay its debts as they become due in the normal course of business; and
- The value of the company's assets is greater than –
  - The value of its liabilities; and
  - The company's stated capital

Further, this is based the most recent financial statements of the company after considering any additional information known or ought to have known by the directors. (Section 57(2)).

**6. Why should the Auditor provide a SLAPs 1 Opinion?**

The Section 56(2) of the Act requires the provision of the Certificate on solvency. (i.e a "true and correct" opinion has been required) Audit steps carried out are not expected to provide such levels of assurance. However, considering the requirement of the Act, as well as the public perception, the Audit Faculty agrees that a SLAPs 1 Opinion be provided. Further, the Report (Report of Auditors) and the opinion is based on the premise that as per the Companies Act No 7 of 2007, a company is deemed solvent, based on the requirement as per Section 57(1) of the said Act.

**Report of the Auditors**

**To the Board of Directors of .....**

We have audited the accompanying Statement of Solvency (“Statement”) as at (date of most recent financial statements prepared in accordance with Section 151 of the Act) prepared by the Board of Directors for the purpose of Section 57 of the Companies Act No. 07 of 2007 (“Act”) which has been derived from the Audited Financial Statements of the Company for the year ended at (date of most recent financial statements prepared in accordance with Section 151 of the Act).

The Board of Directors is responsible to take into account such matters under Section 57 of the Act. Our responsibility is to provide a report at its request, on the application of Section 57 of the Act by the Board of Directors. The accompanying Statement is the responsibility of the Board of Directors.

We conducted our audit in accordance with Sri Lanka Auditing Standards and Sri Lanka Audit Practice Statements. Those Standards and Practice Statements require that we plan and perform the audit to obtain reasonable assurance about whether the Statement is free of material misstatements. Our audit includes examining, on a test basis, evidence supporting the amounts, disclosures in the Statement, and inquiring of management as to whether subsequent events have occurred up to (the date of authorisation of dividend recommendation), which might affect the value of the Company’s asset and liabilities as at the (date of most recent financial statements prepared in accordance with Section 151 of the Act). An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Statement. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying Statement gives a true and fair view of the Solvency of the Company, immediately after the proposed interim / final dividend distribution of Rs. .... in accordance with Section 57 of the Companies Act No. 07 of 2007, as at (date of most recent financial statements prepared in accordance with Section 151 of the Act).

CHARTERED ACCOUNTANTS

Colombo

Date: (date the Board authorized the distribution in terms of S 56(2))

*To be printed on the Client's letter head*

*Addressed to the Audit Partner/ Firm*

*Date*

Dear Sirs,

**Directors' Statement of Solvency**

**Final Dividend of Rs .../- per share amounting to Rs ...../-  
Solvency Test in accordance with Section 57 of the Companies Act, No 07 of 2007**

We acknowledge our responsibility for the assessment of solvency of the Company, immediately after the distribution of dividends is made, based on the audited financial statements for the year/ period ended.....

We have made appropriate inquiries of directors and officers of the Company with the relevant knowledge and experience and have tested for solvency in accordance with Section 57 of the Company's Act, No 07 of 2007.

**1) Ability to pay debts in the normal course of business.**

The Company considers that a positive net current asset position /adequate cash and cash equivalents or borrowing arrangements with financial institutions for which offer letters are available with us, would determine the Company's ability to pay its debt becoming due in the normal course of business.

a) Net Current Asset/ Liability position as at .....(the date of the audited accounts)

Current Assets	
	X
	X
	X
Total Current Assets	XXXXX
Current Liabilities	X
	X
	X
Total Current Liabilities	XXXXX
<b>Net Current Assets/ Liabilities</b>	<b>XX</b>

b) Funding the dividends payments

*The directors need to demonstrate the capacity of the Company to pay the dividends by comparing the cash and cash equivalents available within the Company and if there are any deficits, the necessary borrowing arrangements with the financial institutions.*

2) **Value of Company's Assets less liabilities, stated capital and proposed dividends**

Non Current Assets		
	X	
	X	
	X	
Total Current Assets	XXXXX	
Current Assets		
	X	
	X	
	X	
Total Current Assets	XXXXX	
<b>Total Assets</b>		<b>XXXX</b>

Current Liabilities	X	
	X	
	X	
Total Current Liabilities	XXXXX	
Current Liabilities		
	X	
	X	
	X	
Total Current Liabilities	XXXXX	
<b>Total liabilities</b>		<b>(XXXX)</b>
<b>Stated Capital</b>		<b>(XX)</b>
<b>Adjustments required by S 57 (2) b</b>		<b>(XX)</b>
<b>Proposed Distribution</b>		<b>(XXX)</b>
		<b>XXXXX</b>

### 3) Solvency test

Based on the above assessments and after considering circumstances which could affect the value of the Company's assets and liabilities as at this date, we confirm, to the best of our knowledge and belief, that the Company will satisfy the solvency test required by the Act, immediately after the distribution of the proposed interim/final dividends of Rs.....

Yours Faithfully

*To be signed by the Board of directors*