

HKFRSs / IFRSs UPDATE

2010/21

29 November 2010

HKFRSs INTERPRETATION 5 PRESENTATION OF FINANCIAL STATEMENTS – CLASSIFICATION BY THE BORROWER OF A TERM LOAN THAT CONTAINS A REPAYMENT ON DEMAND CLAUSE

How should a term loan that contains a repayment on demand clause be presented by the borrower in its statement of financial position?

- (i) Should it be presented in accordance with the scheduled repayment dates? or
- (ii) Should it be entirely presented as current, given the lender's overriding right to demand repayment at any time?

This is the question addressed by [HKFRSs Interpretation 5](#) issued on 29 November 2010 by the HKICPA.

STATUS

Final HKFRSs
Interpretation

EFFECTIVE DATE

Immediate upon release
on 29 November 2010

Background

"Term loans" are loans which are repayable on a specified date or in instalments over a period of time, usually in excess of one year. Loan facility agreements for such term loans will set out the basic terms, such as the scheduled repayment date(s), interest rates and additional charges for early repayment, and may also include specific clauses which define default events which would give the lender the right to accelerate the repayment terms if those events occur.

In addition to defining events of default and the consequences of their occurrence, some term loan agreements include an overriding repayment on demand clause, which gives the lender the right to demand repayment at any time, at their sole discretion and irrespective of whether a default event has occurred. In such cases, the question arises as to whether the term loan should be presented in the statement of financial position in accordance with the scheduled repayment dates, or whether the entire loan should be presented as current, given the lender's overriding right to demand repayment at any time.

IFRS Interpretations Committee Agenda Decision

The IFRS Interpretations Committee received a request on the classification of a liability as current or non-current when the liability is not scheduled for repayment within twelve months after the reporting period, but may be callable by the lender at any time without cause.

The IFRS Interpretations Committee noted that paragraph 69(d) of IAS 1 requires that a liability must be classified as a current liability if the entity does not have the unconditional right at the reporting date to defer settlement for at least twelve months after the reporting period. The IFRS Interpretations Committee noted that IAS 1 provides sufficient guidance on the presentation of liabilities as current or non-current.

Further details are available at the [IFRIC November 2010 Update](#).

HKFRSs Interpretation 5

The Interpretation addresses the current vs. non-current loans classification question with reference to the criteria for classification of liabilities as current or non-current as set out in paragraph 69 of HKAS 1 (IAS 1). The Interpretation states that the classification of a term loan as a current or non-current liability in accordance with paragraph 69(d) of HKAS 1 should be determined by reference to the rights and obligations of the lender and the borrower, as contractually agreed between the two parties. Therefore, in cases where a repayment on demand clause provides the lender with a clear and unambiguous unconditional right to demand repayment at any time at its sole discretion, the entire loan should be classified as current, as the existence of this right means that the borrower does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

The Interpretation also clarifies that the likelihood of the lender exercising this clause may be relevant to certain disclosures required under HKFRS 7 "Financial Instruments: Disclosures" in respect of the entity's approach to managing its liquidity risk, but it is not a relevant consideration for the classification of the loan in the statement of financial position in accordance with paragraph 69(d) of HKAS 1.

Effective Date

The Interpretation is effective immediately upon release as it represents a clarification of a Standard. Where the initial application of the Interpretation constitutes a change of accounting policy, it should be accounted for retrospectively in accordance with HKAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors".

Consistency with IFRSs

The HKICPA considers that the Conclusions set out in the Interpretation are consistent with IFRSs.

Business Impact

Companies should start reviewing their loan facility agreements now to ascertain whether the Interpretation will result in changes to their existing loans classification. Any such reclassification may trigger a number of important issues including:

- (a) risk management issues – whether a loans reclassification from non-current to current will result in non-compliance with loan covenants
- (b) financial reporting issues – a loans reclassification from non-current to current may also require restating the comparative period disclosures and possibly the need to prepare a third statement of financial position as at the beginning of the comparative period, together with related notes, in accordance with HKAS 1 paragraph 39 requirements.

Implementation Guidance Issued by the HKICPA

The Financial Reporting Standards Committee of the HKICPA has issued the following implementation guidance to assist in the application of the Interpretation:

- (a) [Q&As](#)
- (b) [Illustrative disclosures](#)

BDO's support and assistance on HKFRSs

For any support and assistance on HKFRSs, please talk to your usual BDO contact or Stephen Chan, Partner and Head of Technical & Training at +852 2853 5820 or email StephenChan@bdo.com.hk

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