

The Stock Exchange of Hong Kong Ltd.

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Mr. Steve Ong
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Hong Kong Institute of Certified Public Accountants
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Dear Steve,

HKICPA Exposure Draft on Hong Kong Interpretation 5 Presentation of Financial Statements – Classification by the Borrower of a Term Loan that contains a Repayment on Demand Clause (“Interpretation”) (“Exposure Draft”)

I refer to your letter dated 15 September 2010 on the above to our Authorised Representative, Mr. Joseph Mau, which has been passed to me for my attention.

We have reviewed the Exposure Draft and support the objective of the HKICPA to address the diversity in practice in interpreting HKAS 1 “Presentation of Financial Statements” on the treatment of bank term-loans with a repayment on demand clause. The Exposure Draft clarifies that a term-loan with an overriding repayment on demand clause should be classified as a current liability as the existence of the overriding clause indicates that the borrower does not have an unconditional right at the reporting date to defer settlement. We believe the proposed Interpretation will assist in ensuring consistency in classification.

To provide further background, the HKICPA may wish to consider explaining in the Interpretation why other interpretations supporting a different treatment, which we understand include the following, are not appropriate:-

(a) Interpretation A

Paragraph 69(d) of HKAS 1 requires a liability to be regarded as current when the borrower does not have an unconditional right to defer settlement for at least twelve months after the reporting period. Importantly, there is an immediate reference to paragraph 73 in paragraph 69 and the intention, it appears, is to give context in which paragraph 69(d) is to be applied. Notably, it refers to specific circumstances, namely, where the borrower has the discretion to roll over or extend the obligation. If the borrower has the discretion, the liability can be classified as non-current but

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where the borrower does not have the discretion to roll over, the liability is classified as current. This interpretation takes the view that paragraph 69(d) of HKAS 1 is to be applied by only considering whether there is a discretion held by the borrower to enable it to roll over the loan and the purpose of paragraph 69(d) was not intended to be extended to consider other terms of the loan, such as repayment on demand clauses.

(b) Interpretation B

Paragraph 74 of HKAS 1 states that if the borrower breaches a provision of a long-term loan arrangement before the year end, the liability becomes payable on demand. Therefore there is a trigger for re-classifying a long-term payable to a current liability. A similar argument for a trigger could be made for term-loans which include a right by the lenders to demand immediate repayment. Under this interpretation, the loans are regarded as non-current and they only become current when the trigger is activated, that is, when the lender exercises his right to make the loan repayable immediately. In the absence of the trigger being exercised, the loan is still non-current.

We also believe a Hong Kong Interpretation would only be applicable to interpreting HKAS 1 and it may be argued that it is not an authoritative interpretation of the equivalent International Financial Reporting Standard (IFRS) upon which HKAS 1 is based. As some companies prepare financial statements under IFRSs, to ensure that the Hong Kong Interpretation will also be applied by the Institute's members who prepare or audit financial statements prepared under IFRSs, it may be useful to include a statement to that effect.

The Institute may also wish to consider requesting the IASB to amend IAS 1 in due course as one of its annual improvements projects. Possible suggestions include:-

- (a) Paragraph 69(d) of IAS 1 to be made clearer by deleting the reference to paragraph 73 to address the concerns with Interpretation A mentioned above;
- (b) The words "*it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period ...*" in paragraph 69(d) of IAS 1 could be replaced with "*the counterparty or creditor has an overriding right to demand settlement of the liability, even though the right may not have been exercised at the year end date*". This will make it clear that the rights of the lender are paramount and take precedence over the rights of the borrower. It will also address the concerns with Interpretation B mentioned above;

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- (c) To study the issue concerning “rights to demand immediate repayment” and consider whether there should be a different accounting treatment depending on whether such rights are exercised as mentioned in Interpretation B above;
- (d) Paragraph 73 of IAS 1 to be reworded to require that on or before the year-end date the reporting entity has made and documented a decision to roll over the loan rather than the reporting entity merely having an “expectation” of making a roll over, which is the current requirement; and
- (e) The IASB may wish to re-consider the conceptual basis for classifying liabilities between current and non-current. Should classification into current or non-current be based on “contractual rights” or should it be based on “expectations”? The requirements of paragraphs 69(a) and 69(d) of IAS 1 appear to be inconsistent. Paragraph 69(a) looks at “expectations” whereas paragraph 69(d) looks at “contractual rights”. Paragraph 69(a) appears to require a current liability classification when the borrowing entity “expects to settle” the liability within twelve months after the reporting year-end date, despite the fact that it does not have a contractual obligation to do so.

We hope that the above comments are useful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited



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