

HK Interpretation 5 (Revised)

Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause

This Interpretation has incorporated the Amendments to HKAS 1 *Classification of Liabilities as Current or Non-current* (2020 Amendments) and the Amendments to HKAS 1 *Non-current Liabilities with Covenants* (2022 Amendments). Both amendments are to be applied as a package and are effective for annual reporting periods beginning on or after 1 January 2024, with early adoption permitted. This Interpretation has been updated to incorporate the references to these amendments, but its conclusions are not impacted by these amendments.



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**HK INTERPRETATION 5 (REVISED)
PRESENTATION OF FINANCIAL STATEMENTS –
CLASSIFICATION BY THE BORROWER OF A TERM LOAN THAT CONTAINS A
REPAYMENT ON DEMAND CLAUSE**

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HK Interpretation 5 (Revised) *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause* (HK-Int 5 (Revised)) is set out in paragraphs 1-18. The scope and authority of Interpretations are set out in the *Preface to Hong Kong Financial Reporting Standards*.

References

- HKAS 1 *Presentation of Financial Statements*
- HKFRS 7 *Financial Instruments: Disclosures*

Introduction

IN1 HK-Interpretation 5 *Presentation of Financial Statements – Classification by the Borrower of a Term Loan that Contains a Repayment on Demand Clause* was issued in November 2010.

IN2 This Interpretation was revised in October 2020 as a consequence of Amendments to HKAS 1 *Classification of Liabilities as Current or Non-current* issued in August 2020 (2020 Amendments), and the withdrawal of the IFRS Interpretations Committee's related November 2010 agenda decision *Current/non-current classification of a callable term loan* as a consequence of the Amendments to IAS 1 *Classification of Liabilities as Current or Non-current*. The 2020 Amendments provide further guidance on how to classify debt and other liabilities as current or non-current. In particular, the 2020 Amendments specify that an entity's right to defer settlement as described in paragraph 69(d) of HKAS 1 must exist at the end of the reporting period, and delete the word 'unconditional' from the classification principle in that paragraph.

IN3 In December 2022, the Institute issued Amendments to HKAS 1 *Non-current Liabilities with Covenants* (2022 Amendments) to deal with the classification of long-term loan arrangements with covenants as current or non-current, and defer the effective date of the 2020 Amendments to align with the effective date of the 2022 Amendments. Both amendments are to be applied as a package and are effective for annual reporting periods beginning on or after 1 January 2024, with early adoption permitted.

The 2022 Amendments do not affect the conclusions in this Interpretation.

Background

1. In general, banks normally grant loans that are either demand loans (e.g. loans that are repayable at any time at the discretion of the lender), or term loans (i.e. loans that are repayable on a specified date or in instalments over a specified period, usually in excess of one year). The terms and conditions of the loans are normally stated in the loan agreement or in the loan facility agreement.
2. Typically, the loan agreements for 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 or debt covenant violations which would give the lender the right to accelerate the repayment terms if those events or violations occur.
3. 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, irrespective of whether a default event has occurred and notwithstanding any other terms and maturity stated in the agreement.
4. The HKICPA noted an issue concerning the classification of term loans with repayment on demand clauses as current/non-current liabilities by entities reporting under HKFRSs. This issue relates to whether such a term loan should be classified by the borrower as a non-current liability based on the scheduled repayment date(s) or as a current liability based on the repayment on demand clause set out in the loan agreement.
5. The purpose of this Interpretation is to provide guidance on the classification by the borrower of a term loan that contains a repayment on demand clause, with reference to the criteria for classification of liabilities as current or non-current as set out in paragraph 69 of HKAS 1. Paragraph 69 states:

“An entity shall classify a liability as current when:

- (a) it expects to settle the liability in its normal operating cycle;*
- (b) it holds the liability primarily for the purpose of trading;*
- (c) the liability is due to be settled within twelve months after the reporting period; or*
- (d) it does not have the right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period.*

An entity shall classify all other liabilities as non-current.”

Scope

6. This Interpretation applies where an entity has entered into a contract to borrow funds and the contract includes, amongst its terms and conditions, an overriding right for the lender to demand repayment without notice (or with a notice period of less than 12 months) at its sole discretion.
7. This Interpretation does not address the classification of such contracts by the lender.

Issue

8. This Interpretation addresses the issue as to whether a term loan that contains a repayment on demand clause shall be classified as a current or non-current liability in the borrower’s statement of financial position in accordance with paragraph 69 of HKAS 1.
9. This Interpretation also addresses the issue as to whether the contractual maturity analysis to be disclosed by the borrower in accordance with paragraph 39(a) of HKFRS 7 should classify the cash flows relating to such term loans based on the contractual repayment dates or with respect to the earliest date on which the lender could demand repayment.

Conclusions

10. The classification of a term loan as a current or non-current liability in accordance with paragraph 69(d) of HKAS 1 shall be determined by reference to the existence of the borrower’s right at the end of the reporting period to defer settlement of the liability for at least twelve months after the reporting period. In this regard, the probability of the lender choosing to exercise its rights to demand repayment within the next twelve months after the reporting period is not relevant.
11. Consequently, amounts repayable under a loan agreement which includes a clause that gives the lender the unconditional right to call the loan at any time shall be classified by the borrower as current in its statement of financial position. This is because the borrower under such an agreement does not have a right to defer settlement of the liability for at least twelve months after the reporting period.
12. Similarly, in the contractual maturity analysis disclosed by the borrower in accordance with paragraph 39(a) of HKFRS 7, amounts repayable under a loan agreement that includes a clause that gives the lender the unconditional right to call the loan at any time shall be classified in the earliest time bracket, in accordance with the guidance in paragraph B11C(a) of HKFRS 7.

Disclosures

13. In accordance with paragraph 39(c) of HKFRS 7, the borrower shall describe how it manages the liquidity risk inherent in the financial liabilities included in the contractual maturity analysis as

required under paragraph 39(a) of HKFRS 7. This would include the liquidity risk that arises when the lender has the right to demand repayment of a term loan at any time.

14. In addition, in accordance with paragraph 34(a) of HKFRS 7, the borrower shall also disclose summary quantitative data on its exposure to liquidity risk based on the information provided internally to management, when this information is prepared on a different basis from that disclosed under paragraph 39(a) of HKFRS 7. This would typically occur in the case of term loans which are callable by the lender, where management does not expect the lender to exercise its rights to demand repayment. In such cases, the internal information on liquidity risk would generally be based on expected repayment dates with reference to the schedule of repayments set out in the term loan agreements. Such expected cash flow information should be disclosed in accordance with paragraph 34(a) of HKFRS 7, in addition to the contractual maturity analysis based on the earliest possible date that the borrower could be required to repay, which is disclosed under paragraph 39(a) of HKFRS 7.

Effective date

15. This Interpretation is a clarification of an existing standard and shall have immediate effect.

Transition

16. Where the initial application of this Interpretation constitutes a change in accounting policy, it should be accounted for retrospectively in accordance with HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Consistency with IFRSs

17. HKAS 1 and HKFRS 7 are adopted from IAS 1, *Presentation of Financial Statements*, and IFRS 7, *Financial Instruments: Disclosures*, respectively.
18. The HKICPA considers that the Conclusions set out in this Interpretation are consistent with IFRSs.