



October 18, 2010

Mr. Steve Ong  
Director, Standard Setting  
Hong Kong Institute of Certified Public Accountants  
37th Floor, Wu Chung House  
213 Queen's Road East  
Wanchai, Hong Kong

Dear Mr. Ong,

Re: Exposure Draft of Hong Kong Interpretation 5 Presentation of Financial Statements –  
Classification by the Borrower of a Term Loan that contains a Repayment on Demand Clause

The Chamber of Hong Kong Listed Companies (the “Chamber” or “CHKLC”) would like to submit our comments to the captioned subject matter. The Chamber is a member organization comprised of listed companies in Hong Kong and is dedicated to matters and issues faced by our members and to the promotion of corporate governance and market efficiency. Our membership now represents 35% of the market in terms of capitalization.

The Chamber reckons that it is a rather common practice for banks to insert the “Repayable on Demand” clause in term loan agreements, especially bilateral agreements (less so for syndicated loans). A term loan agreement usually contains all foreseeable / possible events or circumstances as “Event of Default” so that the bank would have the right to demand early repayment when an event of default occurs. To protect themselves from events or circumstances that are missed out from the list of “Event of Default”, some banks would impose the “Repayment on Demand” clause as a back-up clause. Yet, in reality, banks seldom rely on this “Repayment on Demand” clause if the borrowers are in full compliance with the loan documents. That is only a reserved right to be exercised by the banks in exceptional circumstances that are not covered under the loan covenants. Certainly, it is not beneficial to both parties if banks demand early repayment without any “Event of Default”.

### Our Concerns

In view of the above, we think the proposed accounting treatment of reclassification of a loan as current based on “Repayment on Demand” clause highly inappropriate and would lead to unnecessary market confusion with adverse effects as follows:

- 1) It is misleading to readers of the financial statement, giving the wrong indication about the liquidity situation of a company.
- 2) It will result in the company breaching the liquidity ratios as stated in financial covenants (e.g. current ratio) for its term loans or other borrowing. This may trigger an “Event of Default” and lead to banks or lenders demanding early repayment.
- 3) By adversely affecting a company's quick ratio or liquidity ratios, it will cause the company to be in negative working capital. The company concerned may not be considered as going concern; smaller companies will become increasingly difficult to get finance as their financial ratios are not impressive.

Such adverse effects can be avoided by not introducing the proposed accounting treatment.

### **Our Recommendations**

We therefore take the view that a loan with this “Repayment on Demand” clause may still be regarded as a term loan provided that:

- (a) the bank has not indicated to the borrower that such clause will be exercised;
- (b) the borrower is in full compliance with the terms of the loan documents; and
- (c) the directors of the borrower, after conducting their relevant due diligence and enquiry, are reasonably of the opinion that the bank will not demand for a repayment of the loan based on that clause for the next 12 months.

We recommend that instead of having a reclassification, a Note to the Accounts shall be provided in the financial statement stating that the loan agreement of such term loans contained a standard repayable on demand term and further explaining that the management reasonably believes that the loan will not be required to be repaid within the next 12 months.

At the same time, companies will request their banks to issue them a “comfort letter” as evidence, and the language and terms of the comfort letter will be standardised and agreed between the Hong Kong Association of Banks and HKICPA.

Alternatively, companies can negotiate with their bankers or lenders to grant waiver or develop supplementary clause in loan agreements to modify, amend or delete the “Repayment on Demand” clause.

I hope you would give our recommendations due consideration in order that the negative impact to listed companies will be lessened and the overall stability of the market will be maintained. If you have any questions about our views and recommendations, please feel free to contact me.

Yours sincerely,  
For and on behalf of  
The Chamber of Hong Kong Listed Companies

A handwritten signature in blue ink, appearing to read 'Mike Wong', with a stylized flourish at the end.

Mike Wong  
Chief Executive Officer