

**LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD**

MFRS Application and Implementation Guide 2

**Classification by the borrower
of a term loan that contains
a repayment on demand clause**

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MFRS Application and Implementation Guide 2 *Classification by the borrower of a term loan that contains a repayment on demand clause* is issued by the MASB in respect of its application in Malaysia.

MFRS Application and Implementation Guide 2

Classification by the borrower of a term loan that contains a repayment on demand clause

The Committee received a request about the classification by the borrower of a term loan that contains a repayment on demand clause stated in the term loan agreement.

In the fact pattern described in the request:

“Banks as lenders normally grant a principal aggregate sum to the borrower, upon the terms and subject to the conditions contained in the term loan agreement. Generally, the term loan agreement will set out the basic terms such as repayment instalments, repayment dates, interest rates, additional charges for early repayment, securities and specific clauses on default event and debt covenants.

Some of the term loan agreement includes, amongst the terms and conditions, a repayment on demand clause, where the lender reserves the right to demand repayment at any time at its sole discretion with or without written notice to the borrower, irrespective of whether or not any event of default has occurred and notwithstanding any other terms and conditions stated in the term loan agreement.

With the repayment on demand clause stated in the term loan agreement, there is a concern on whether such term loan should be classified as a current liability in its entirety in the financial statements of the borrower, due to the requirements of paragraph 69(d) of MFRS 101¹ *Presentation of Financial Statements*.”

The *Conceptual Framework for Financial Reporting* includes guidance on the “Substance of contractual rights and contractual obligations”. Paragraphs 4.59 and 4.61 (emphasis added) say:

4.59 ... In some cases, the substance of the rights and obligations is clear from the legal form of the contract. **In other cases, the terms of the contract or a group or series of contracts require analysis to identify the substance of the rights and obligations.**

¹ On 16 March 2020, MASB issued *Classification of Liabilities as Current or Non-current* (Amendments to MFRS 101), which are word-for-word *Classification of Liabilities as Current or Non-current* (Amendments to IAS 1 *Presentation of Financial Statements*) issued by the International Accounting Standards Board (IASB). The amendments affect requirements in MFRS 101 for the presentation of liabilities. Specifically, they clarify one of the criteria for classifying a liability as non-current – that is, the requirement for an entity to have the right to defer settlement of a liability for at least 12 months after the reporting period. The amendments are effective for annual reporting periods beginning on or after 1 January 2022. Earlier application is permitted. However, as a result of the COVID-19 pandemic, the IASB has published an exposure draft proposing to delay the effective date of the amendments by one year to annual reporting periods beginning on or after 1 January 2023. At the 24 June 2020 IASB Board meeting, all members agreed with the decision to delay the effective date and plan to issue the amendments in July 2020.

4.61 **Terms that have no substance are disregarded.** A term has no substance if it has no discernible effect on the economics of the contract. **Terms that have no substance could include**, for example:

- (a) terms that bind neither party; or
- (b) rights, including **options, that the holder will not have the practical ability to exercise in any circumstances.**

Whether or not a contractual right has no substance needs to be determined based on the facts and circumstances in each case.

The Committee observed that in the various rulings² upheld by the Courts of Law in Malaysia, in the absence of a default being committed by the borrower, the bank is not entitled to exercise its right pursuant to the overriding clause to demand for repayment of the term loan from the borrower at any time due to the repayment tenure. Hence, the liability associated with such term loan shall be classified by the borrower in its statement of financial position as current and/or non-current liability in accordance with other terms and conditions as spelled out in the term loan agreement. The classification of the liability associated with such term loan should not be based solely on the overriding clause to demand for repayment of the term loan from the borrower at any time.

A borrower needs to reassess its ability to defer settlement of a liability for at least twelve months after the reporting period based on the individual term loan agreements executed notwithstanding the existing legal precedence established that the inclusion of a repayment on demand clause in the term loan agreement governed under the laws of Malaysia will not in itself have an effect to a borrower's ability to defer settlement of a liability for at least twelve months after the reporting period as the clause would not override the other terms and conditions provided in the term loan agreement.

Any change to the precedence established by the Courts of Law in Malaysia relating to the interpretation of the repayment on demand clause in the future may have an impact to the conclusion, which may then warrant a revisit to the conclusion made in this Guidance.

² *Bank Bumiputra Malaysia Berhad v Mae Perkayuan Sdn Bhd*, in the Supreme Court
Bumiputra-Commerce Bank Berhad v Chendering Development Sdn Bhd, in the Court of Appeal
Sabah Bank Berhad v Master Perkasa (M) Sdn Bhd, in the High Court in Sabah and Sarawak