

ICAEW KNOW-HOW
FINANCIAL REPORTING FACULTY



Contract modifications under IFRS

17 DECEMBER 2020

This webinar will commence shortly



Introduction

Sally Baker
Technical manager
ICAEW



Today's presenters



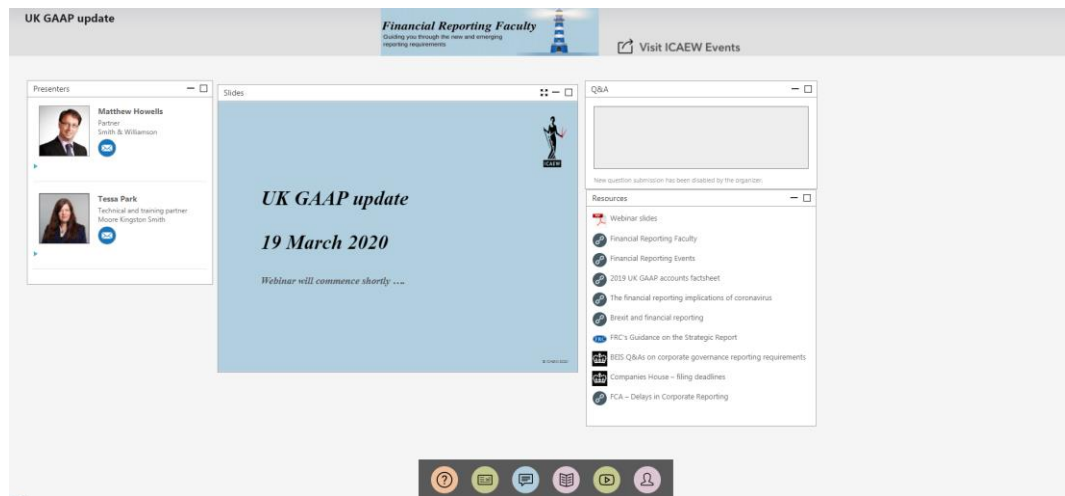
Phil Barden
Partner
Deloitte



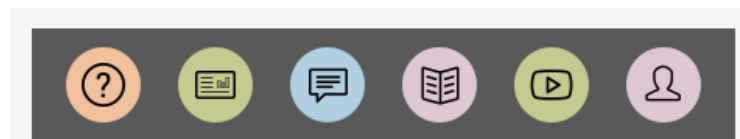
Sam Roberts
Senior Manager
KPMG

Customise your screen

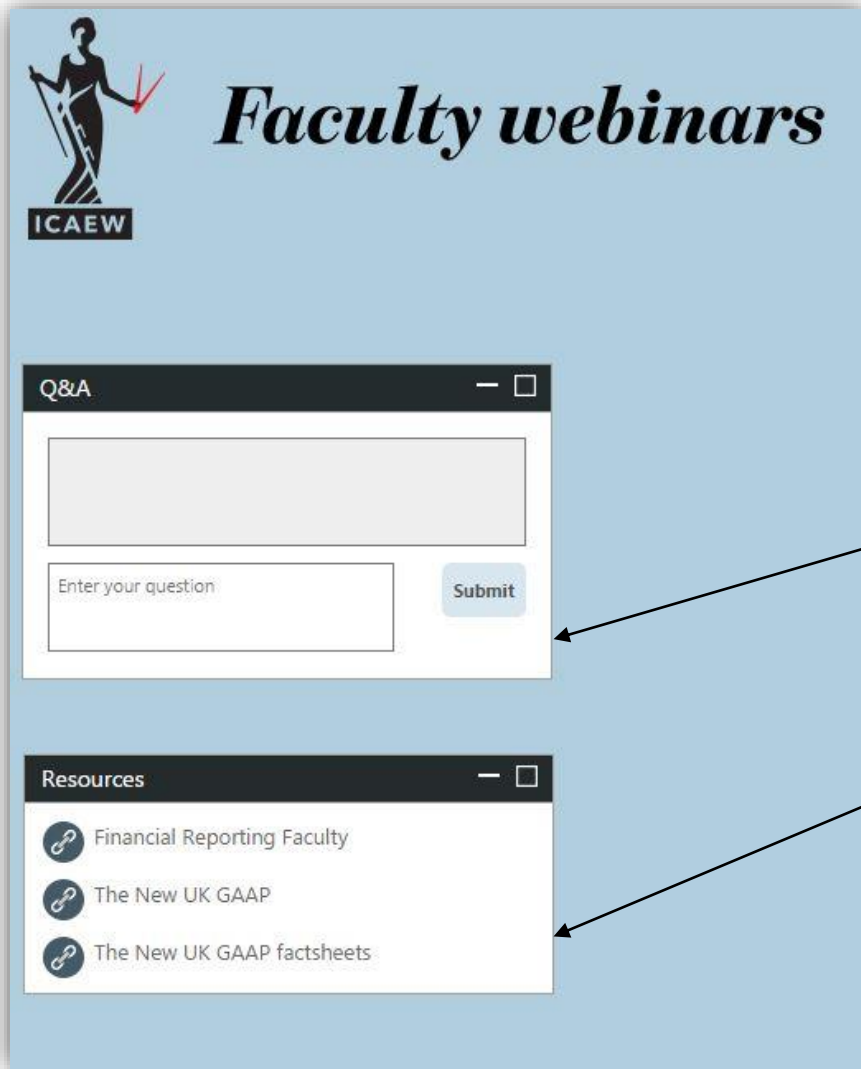
- You can customise the webinar console by moving and resizing the widgets



- You can also minimise and maximise the widgets by clicking on the icons located in the dock at the bottom of the console



Ask a question and access resources



The screenshot shows the 'Faculty webinars' interface. At the top left is the ICAEW logo, which features a stylized figure holding a scale and a sword, with the text 'ICAEW' below it. To the right of the logo is the title 'Faculty webinars' in a large, bold, serif font. Below the title, there are two main sections:

- Q&A:** A window with a title bar 'Q&A'. It contains a large text input area, a smaller input field with the placeholder text 'Enter your question', and a blue 'Submit' button.
- Resources:** A window with a title bar 'Resources'. It contains a list of three items, each with a link icon (a chain link) and text: 'Financial Reporting Faculty', 'The New UK GAAP', and 'The New UK GAAP factsheets'.



Audio problems?

- Ensure your volume is turned on
- If you experience poor sound quality try refreshing your page.

Ask a question

Type your question into the box, then click submit.

Download resources

Access related resources, including the presentation slides

Contents – Accounting for modifications

IFRS 15 Revenue from Contracts with Customers

IFRS 16 Leases

IFRS 9 Financial Instruments

IAS 19 Employee Benefits and IFRS 2 Share-based Payment

Poll question 1

Has the pandemic resulted in increased uncertainties affecting your business's, or those of your clients, revenue recognition?

- Not really
- Yes, but those uncertainties are now mostly resolved
- Yes, and there continue to be some significant uncertainties



IFRS 15 Revenue from Contracts with Customers

ACCOUNTING FOR CONTRACT MODIFICATIONS

IFRS 15 Revenue from Contracts with Customers

This session is about modifications ...

... but there are things to think about even when a contract isn't modified:

- Step 1 – is it still probable that amounts will be collected in full?
 - If using a portfolio approach, do you need to disaggregate portfolios?
 - Have you failed step 1 for some contracts? Consequences?

- Step 3 – have estimates of variable consideration changed?
 - Do you need to change the amount by which you are constraining estimates?
 - Impact of late delivery penalties – need to think about guidance in IFRS 15:85
 - i.e. should they be allocated to individual deliveries or contract as a whole?

IFRS 15 Revenue from Contracts with Customers

This session is about modifications ...

- Step 5 – has there been an impact on your measure of progress (especially if using cost)?
 - Which costs should be excluded as attributable to significant inefficiencies?
 - Have future necessary costs increased?
- Step 5 – have point in time deliveries been delayed?
 - If so, prima facie, revenue recognition will also be delayed
 - But watch out for bill and hold scenarios
 - Don't capitalise costs attributable to significant inefficiencies
- Disclosures
 - What additional explanations may be needed in your financial statements?

IFRS 15 Revenue from Contracts with Customers

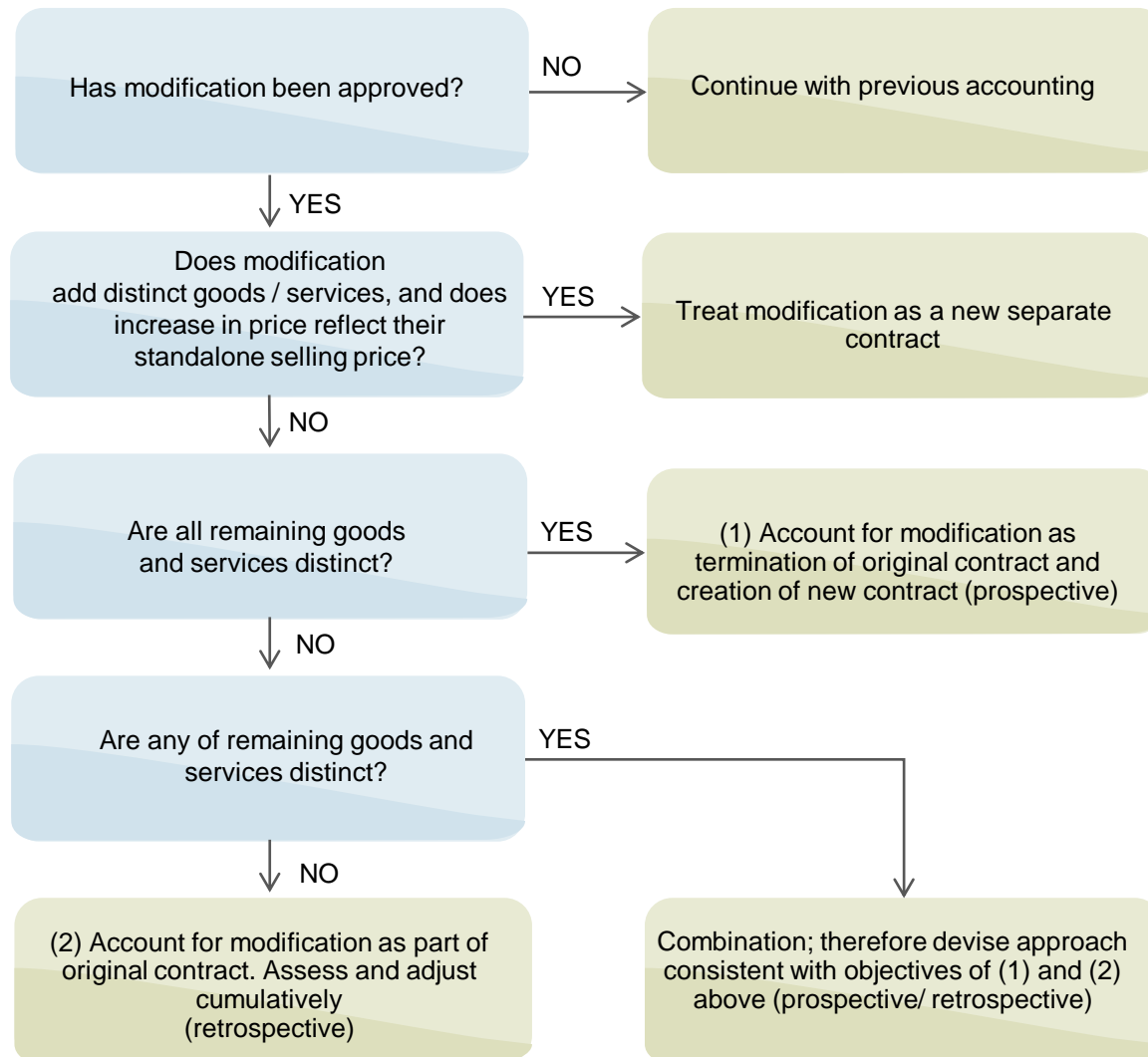
You think you have a modification ...

... but do you really?

- A customer is granted a price concession:
 - Is this a contract in which a price concession was always considered to be possible?
 - Or is this an unexpected change that has been specifically negotiated, eg as a consequence of the pandemic?
 - Was it provided in response to a claim by the customer under the contract?
- Customers are provided with additional goods / services for free
 - Was this negotiated with the customer or was it a voluntary action of the seller, not agreed with the customer in advance?
 - Has an obligation been created to supply further goods / services for free in the future?

IFRS 15 Revenue from Contracts with Customers

How does IFRS 15 approach modifications?



IFRS 15 Revenue from Contracts with Customers

How does IFRS 15 approach modifications?

- Quite a prescriptive approach
- Watch out for interaction with the series guidance IFRS 15:22(b) – future goods and services may well be distinct even though the modification occurs part way through the performance obligation
- Even where modification is prospective, an adjustment may be needed to pre-modification revenues if goods / services were not provided in accordance with the contractual terms – see illustration in Example 5 Case B accompanying IFRS 15

IFRS 15 Revenue from Contracts with Customers

Seller grants extended payment terms

- Consider whether collectability threshold is still met? (Step 1)
- Consider whether contract now includes a significant financing component?

IFRS 15 Revenue from Contracts with Customers

Disclosures

- FRC has been sending strong messages on disclosure
- In general, not all IFRS 15 disclosures have previously been as complete and clear as expected
- This year, even greater need to tell a clear story and explain associated uncertainties

IFRS 15 Revenue from Contracts with Customers

Specific disclosures that might need to be enhanced

- Revenue recognised in current period in relation to performance obligations satisfied in previous periods
 - Typically, this is the effect of releasing constrained revenue
 - This year, the amount may be negative for some entities
- Changes to typical timing of payment / payment terms, and impact on contract assets and liabilities
- Explanation of significant changes to contract assets and liabilities, including quantitative information on key impacts
- Significant judgements, and changes in judgements, relating to:
 - Assessing when control is transferred to customer
 - Estimating variable consideration
 - Constraining estimates of variable consideration
 - Measuring obligations for returns, refunds and similar obligations



IFRS 16 Leases

ACCOUNTING FOR LEASE MODIFICATIONS

IFRS 16 Leases

Lessee accounting – new exemption

- Practical expedient allowing specific departure from IFRS 16 rules for lessees
- Only applies where:
 - Rent concession arises due to COVID-19
 - Overall consideration is substantially the same or less
 - Any reductions are only to payments due on or before 30 June 2021
 - No substantive change to other terms / conditions
- Revised (lower) future payments are discounted at original rate
- Credit taken to P&L as reduction in lease expense (to be disclosed)
- When does credit hit P&L?

IFRS 16 Leases

Lessee accounting – other modifications

Assuming neither full nor partial termination of lease:

- Determine new discount rate
- Remeasure lease liability by discounting revised lease payments at new rate
- Adjust carrying amount of right of use asset by change in lease liability

- Thereafter, interest expense is based on new rate

IFRS 16 Leases

Lessor accounting

- No special exemptions granted for lessors
- Modification to an operating lease
 - Treat as a new lease from the effective date of the modification
 - Include any prepaid or accrued lease payments as part of the payments for the new lease
- Watch out for expected credit losses under IFRS 9
 - Applies to operating lease receivables
 - Also reasonable to apply to accrued operating lease income, including lease incentives
- If investment property, watch out for interaction with IAS 40 accounting



IFRS 9 Financial Instruments

ACCOUNTING FOR CONTRACT MODIFICATIONS

Modification of financial liabilities

Key messages

- Under IFRS 9, non-substantial modifications of liabilities result in an immediate gain or loss in the P&L
- We expect a significant increase in the number of modifications due to COVID-19

Agenda

- Amortised cost principles
- Modification rules
- Example

Amortised cost principles

The effective interest rate (EIR)

- The rate that exactly discounts the expected future contractual cash flows to equal the carrying amount
- This can be seen as the rate implicit in the cash flows or the Internal Rate of Return (IRR)
- The EIR is set at the outset and can only be changed in limited circumstances

Amortised cost carrying value

- Equals the expected future contractual cash flows discounted at the EIR

Modification process

Stage 1 – is it a modification?

- Yes – contractual terms renegotiated / modified
- No – Repayment in line with original terms

Stage 2 – substantial modification tests

- **Quantitative test** – substantial if the PV of the cash flows (including modification fees) are at least 10% different under the new terms
- Both old and new cash flows discounted at original EIR
- **Qualitative test** – If not substantial per the above, qualitative factors indicating the terms are substantially different can also be considered

Stage 3 – Accounting

Substantial modifications of liabilities - Accounting

Tests	Substantial per quantitative / qualitative test <ul style="list-style-type: none">• Difference in NPVs > 10% (B3.3.6)*• Or there are qualitative factors suggesting substantial that are not captured by 10% test
Accounting treatment	De-recognition <ul style="list-style-type: none">• Carrying value of old liability de-recognised• New liability recognised at FV• Gain or loss in P&L
Costs and fees incurred	P&L immediately IFRS 9.B3.3.6

*PV of new CFs (including fees) at original EIR at least 10% different = substantial

Non-substantial modifications of liabilities- Accounting

Tests	Non-substantial per tests <ul style="list-style-type: none">• Difference in NPVs < 10% (B3.3.6)*• And no qualitative factors suggesting substantial that are not captured by 10% test
Accounting treatment	Immediate gain or loss in P&L <ul style="list-style-type: none">• New carrying value (excluding fees) is PV of modified cash flows discounted at original EIR• Difference is taken as immediate gain or loss in P&L (B5.4.6)
Costs and fees incurred	Adjust carrying amount and increase EIR IFRS 9.B3.3.6

*Scope to revise EIR (B5.4.5) and not recognise an immediate gain or loss is very limited

Loan modification example

- Party Party Ltd (PP) is a hospitality company with a 30 June year end. On 30 June 2019 they take out a 5 year interest only loan for £1m at 5% interest payable annually and the £1m repayable in a final bullet payment at the end of 5 years.
- PP pays £100k of arrangement fees upfront on 30 June 2019.
- How should they have accounted for this?

Solution – initial amortised cost accounting

- Record the net proceeds of £900k and calculate the IRR

Y/E 2019	2020	2021	2022	2023	2024
£900k	£(50k)	£(50k)	£(50k)	£(50k)	£(1,050k)

- IRR or EIR = 7.47%

Y/E	B/fwd	EIR charge	Payment	C/fwd
2020	£900k	£67.2k	£(50k)	£917.2k
2021	£917.2k	£68.5k	£(50k)	£935.7k
2022	£935.7k	£69.9k	£(50k)	£955.6k
2023	£955.6k	£71.4k	£(50k)	£977.0k
2024	£977.0k	£73.0k	£(1,050k)	-

Loan modification example - continued

- PP is significantly impacted by COVID during the year ended 30 June 2020. As a result they agree a modification of their loan contract on 30 June 2020, with the bank (where the bank gives them a payment holiday from 1 July 2020 to 30 June 2021). This is not a payment deferral, the interest payment due 30 June 2021 is waived. Assume there are no modification fees payable to the bank but PP pays £10k to external advisers for assisting them with the terms of the modification.
- How do we determine whether this is a substantial or non-substantial modification?

Applying the quantitative test

- Poll: Per the quantitative test, is the modification substantial or non-substantial?

	PV @ original EIR 7.47%	Now 30/6/20 (fees)	2021	2022	2023	2024
Old	£(917.2k)	-	£(50k)	£(50k)	£(50k)	£(1,050k)
New	£(870.7k)	-	-	£(50k)	£(50k)	£(1,050k)

- The table above shows the present value of the original and modified cash flows (including modification fees).
- The adviser fees are not considered modification fees

Poll question 2

Applying the quantitative test, is the modification substantial or non-substantial?

- a) Substantial
- b) Non-substantial

Solution – quantitative and qualitative tests

	PV @ original EIR 7.47%	Now 30/6/20 (fees)	2021	2022	2023	2024
Old	£(917.2k)	-	£(50k)	£(50k)	£(50k)	£(1,050k)
New	£(870.7k)	-	-	£(50k)	£(50k)	£(1,050k)

- Difference in NPV of cash flows £46.5k
- 5.07% different
- Assume there are no qualitative factors that suggest it is substantial
- Therefore – Non-substantial
- What would the accounting entries be?

Solution – Non substantial modification calculating modification gain / loss

	PV @ original EIR 7.47%	2021	2022	2023	2024
Old	£(917.2k)	£(50k)	£(50k)	£(50k)	£(1,050k)
New	£(870.7k)	-	£(50k)	£(50k)	£(1,050k)

- Difference in NPV of cash flows (excluding costs and fees incurred) discounted at original EIR is £46.5k
- Note - Interest has already been charged for 2020

Recognise immediate gain / loss in P&L in 2020

Dr Loan liability £46.5k

Cr P&L £46.5k

Solution – Non substantial modification accounting for costs fees

- Adjust the new carrying value by deducting the costs and fees incurred (£870.7k – £10k) and recalculate the IRR

Y/E 2020	2021	2022	2023	2024
£860.7k	-	£(50k)	£(50k)	£(1,050k)

- IRR or EIR = 7.79%

Recognise interest at adjusted EIR of 7.79% in 2021

Dr P&L £67k ($£860.7k \times 7.79\%$)

Cr Loan liability £67k

Non-substantial loan modifications – key points to check

Question where there isn't an immediate gain or loss recognised at the point of modification

Check underlying amortised cost accounting (especially in relation to fees)

Check the logic: less cash paid or later payments = immediate gain



IAS 19 Employee Benefits and IFRS 2 Share-based Payment

Employee benefits and share-based payments

Employee benefits

- Most bonus / incentive schemes are discretionary, so scope for modifications is limited
- Changes to estimates would go to P&L as they arise

Equity settled share based payments

- Modifications only accounted for if beneficial to employee / counterparty
- Most common example: reduction in exercise price
- Recognise incremental FV (measured at modification date) over remaining modified vesting period

Ask a question



Faculty webinars

Q&A

Enter your question

- Resources

 - [Financial Reporting Faculty](#)
 - [The New UK GAAP](#)
 - [The New UK GAAP factsheets](#)

Ask a question

Type your question into the box, then click submit.

Faculty resources

icaew.com/financialreporting

- Accounting standards webpages

icaew.com/ifrs15

icaew.com/ifrs9

- Factsheets icaew.com/frffactsheets

- IFRS 9 Financial Instruments - overview
- Revenue from Contracts with Customers
- IFRS 16 Leases

- COVID-19 and financial reporting

icaew.com/coronavirus/financial-reporting

- Webinar recordings icaew.com/frfwebinars

- By All Accounts magazine icaew.com/byallaccounts

The screenshot displays two pages from the ICAEW Financial Reporting Faculty website. The top page is titled 'REVENUE FROM CONTRACTS WITH CUSTOMERS IFRS Factsheet', published on 4 July 2014 and last updated on 16 November 2016. The bottom page is titled 'IFRS 9 FINANCIAL INSTRUMENTS - OVERVIEW IFRS FACTSHEET', published on 21 October 2016 and last updated on 21 October 2016. Both pages feature a table of contents on the right side.

Section	Page
Section 1	1
Section 2	2
Section 3	3
Section 4	6
Section 5	14
Section 6	15
Section 7	19
Section 8	20
Section 9	22

Additional content visible on the IFRS 9 page includes:

- Financial instruments - overview**: This factsheet outlines the key requirements of IFRS 9 Financial Instruments in respect of classification and measurement of financial instruments, including impairment of financial assets, and compares those requirements with those of its predecessor, IAS 39 Financial Instruments: Recognition and Measurement. Its focus is on how IFRS 9 will affect non-financial sector entities. Hedge accounting will be covered in a separate factsheet.
- Key regulations for this factsheet**: This factsheet includes links and references to key regulations. There's a summary of the links, and guidance on how to use them, on page 2.
- Section 1 Overview**: In July 2014, the IASB published the final version of IFRS 9 Financial Instruments, bringing together the classification and measurement, impairment and hedge accounting pieces of its long-running project to replace IAS 39 Financial Instruments: Recognition and Measurement. The package of requirements introduced by the new standard includes:
 - Adopting a principles-based approach to the classification and measurement of financial assets – driven by the business model in which the asset is held and its cash-flow characteristics.
 - Adopting a more forward-looking 'expected loss' model to account for impairment of financial assets.
 - Removing the counter-intuitive requirement that meant in certain instances an entity would recognise gains in the fair value of a financial liability in profit or loss when its own credit risk deteriorated and losses when it improved; and
 - Introducing a substantially-reformed approach to hedge accounting that better aligns the accounting treatment with an entity's risk management activities (to be covered in a separate factsheet).
- IFRS 9 is generally effective for annual periods beginning on or after 1 January 2018, with early application permitted (see section 13).** All entities will need to assess carefully the extent to which their financial reporting will be affected by the new standard. While many of the changes will have the biggest impact on financial sector businesses, other corporations – which are the focus of this factsheet – should not underestimate the potential impact of the standard.

Future events

For details, please visit [icaew.com/frfevents](https://www.icaew.com/frfevents)



Bitesize Briefings
COVID-19 series

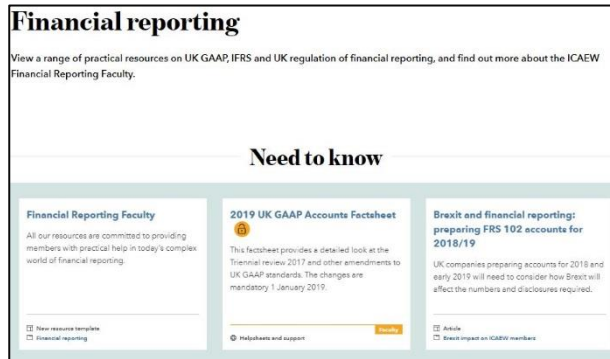


Webinars
Our 2021 programme will be available soon



2020 Members' event – recordings available
Going concern and resilience: lessons learned from COVID-19 [icaew.com/goingconcernevent](https://www.icaew.com/goingconcernevent)

Financial reporting at your fingertips



We are committed to providing members with practical help in today's complex world of financial reporting.

Visit [icaew.com/financialreporting](https://www.icaew.com/financialreporting) for more information.



You can also follow us [@ICAEW_FRF](https://twitter.com/ICAEW_FRF)

to keep up-to-date with the latest financial reporting developments and breaking faculty news.

Financial reporting news and insights

Keep up to date with the latest news and insights in financial reporting with articles from ICAEW's Financial Reporting Faculty at [icaew.com/frnews](https://www.icaew.com/frnews)

Questions



Phil Barden
Partner
Deloitte



Sam Roberts
Senior Manager
KPMG

Thank you for attending



Please take the time to fill out our short survey:
[Survey link](#)



Contact the Financial Reporting Faculty

Phone: +44 (0)20 7920 8533

Email: frfac@icaew.com

Web: icaew.com/frf

This webinar is presented by the Financial Reporting Faculty.

Financial Reporting Faculty membership gives you access to exclusive premium resources including our factsheets, monthly webinars, bitesize recordings, discount on events and conferences and extensive online resources to support your career.

For more information about faculty membership and our latest joining offers, please visit icaew.com/joinfrf or for more information about Faculties Online, please visit icaew.com/subscribeo.

ICAEW will not be liable for any reliance you place on the information in this presentation. You should seek independent advice.

