IFRS Technical Interpretation	2019/15
Title	Fees paid to the lender on a non-substantial modification
Relevant accounting standard(s)	IFRS 9 *Financial Instruments*

Background

When there has been a modification to the contractual terms of a financial liability that an entity has determined to be non-substantial, that financial liability is not extinguished i.e. the financial liability is not derecognized. Instead, the entity accounts for a modification of the original financial liability.

During 2016 and 2017, the IFRS Interpretations Committee ('the Committee') discussed the appropriate accounting for modified financial liabilities (measured at amortized cost) which have not been derecognized.[1] During those discussions, the Committee noted that IFRS 9.5.4.3 contains specific requirements in respect of modified financial assets (measured at amortized cost) which have not been derecognized and concluded that these requirements were equally applicable to modified financial liabilities (measured at amortized cost) which have not been derecognized. This is because the definition of amortized cost in Appendix A of IFRS 9 applies equally to financial liabilities and financial assets. The International Accounting Standards Board ('the Board') agreed with the conclusions of the Committee and highlighted this decision by inserting a new paragraph (BC4.253) in the basis for conclusions to IFRS 9.

Consequently, in order to account for the non-substantial modification of a financial liability, an entity is required to apply the requirements of IFRS 9.5.4.3. In addition, an entity should apply the specific requirements of IFRS 9. B3.3.6 concerning any fees or costs incurred as part of the no substantial modification of a financial liability.

In accordance with IFRS 9.5.4.3, a modification gains or loss, being the difference between the original carrying value and the modified carrying value (i.e. the present value of the modified contractual cash flows discounted at the original effective interest rate) is required to be recognized in profit or loss at the date of modification. This is similar to the accounting treatment prescribed for the re-estimation of cash flows of financial assets and financial liabilities in accordance with IFRS 9. B5.4.6 with the exception of the treatment of fees and costs incurred. IFRS 9.5.4.3 contains specific requirements in relation to costs or fees incurred as part of a modification that does not result in de recognition of a financial asset, which are identical to the corresponding requirements for financial liabilities set out IFRS 9.B 3.3.6. In accordance with these requirements, any such costs and fees incurred should adjust the carrying amount of the financial asset (or liability) and be amortized over the remaining term of the modified financial asset (or liability).

[1] See AP6 *Modification/ exchange of financial liabilities that do not result in derecognition* (November 2016) and AP6E *Modifications and exchanges of financial liabilities* (June 2017) discussed by the IFRS Interpretations Committee.

In cases where a borrower pays a fee direct to the lender, a question arises as to whether those amounts should be accounted for as a modified cash flow and therefore form part of the calculation of the modification gain or loss or whether they should be amortized over the remaining term of the modified financial liability.

Issue

When an entity pays a fee to a lender as part of a non-substantial modification, in which cases should those fees be amortized over the remaining term of the modified financial liability?

BDO Technical Interpretation

The accounting treatment of fees paid to the lender as part of a non-substantial modification of a financial liability depends on the substance of those fees, which in turn will depend on the specific facts and circumstances. For example, if the fee payment effectively reimburses the lender for costs it had incurred as part of the modification, it would be appropriate to amortize the fees in accordance with IFRS 9: B3.3.6. In contrast, if the fee payment does not reimburse the lender for any costs incurred, the fee would be part of the modified cash flows i.e. a payment of additional interest or principal, which means that it would form part of the modification gain or loss.

Relevant IFRS 9 extracts

Modification of contractual cash flows

5.4.3 *When the contractual cash flows of a financial asset are renegotiated or otherwise modified and the renegotiation or modification does not result in the derecognition of that financial asset in accordance with this Standard, an entity shall recalculate the gross carrying amount of the financial asset and shall recognize a modification gain or loss in profit or loss. The gross carrying amount of the financial asset shall be recalculated as the present value of the renegotiated or modified contractual cash flows that are discounted at the financial asset's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortized over the remaining term of the modified financial asset.*

Effective Interest Method

B5.4.6 *If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortized cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortized cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. The adjustment is recognized in profit or loss as income or expense.*

Derecognition of Financial Liabilities

B3.3.6 *For the purpose of paragraph 3.3.2, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.*

Modification or exchange of a financial liability that does not result in derecognition

BC4.252 *Concurrent with the development of the amendments to IFRS 9 for prepayment features with negative compensation, the IASB also discussed the accounting for a modification or exchange of a financial liability measured at amortized cost that does not result in the derecognition of the financial liability. More specifically, at the request of the Interpretations Committee, the Board discussed whether, applying IFRS 9, an entity recognizes any adjustment to the amortized cost of the financial liability arising from such a modification or exchange in profit or loss at the date of the modification or exchange.*

BC4.253 *The IASB decided that standard-setting is not required because the requirements in IFRS 9 provide an adequate basis for an entity to account for modifications and exchanges of financial liabilities that do not result in derecognition. In doing so, the Board highlighted that the requirements in IFRS 9 for adjusting the amortized cost of a financial liability when a modification (or exchange) does not result in the derecognition of the financial liability are consistent with the requirements for adjusting the gross carrying amount of a financial asset when a modification does not result in the derecognition of the financial asset.*

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