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IBOR reform – How would the proposed relief be applied?

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"The Board's decisions in March shed more light on its thinking about how the proposed changes to hedge accounting would be applied. It's time for preparers of financial statements to get ready to comment on the forthcoming exposure draft and communicate any concerns they may have."

Chris Spall,
KPMG's global IFRS financial instruments leader

March decisions clarify how potential amendments would apply and when initial relief would end

Highlights

- Limited mandatory reliefs for hedge accounting in the lead up to IBOR reform
- Initial relief would end when uncertainty ceases or when the hedging relationship is terminated
- Clarification of how relief impacts retrospective assessment and measurement
- Have your say – exposure draft expected in May, followed by a 45-day comment period.

Standard setters continue to consider the effects of unprecedented reform of interbank offered rates (IBOR) – the benchmark interest rates that underlie many financial instruments – on existing financial reporting requirements.

The International Accounting Standards Board (the Board) had previously tentatively **decided to amend the financial instruments standards** – IFRS 9 *Financial Instruments* and IAS 39 *Financial Instruments: Recognition and Measurement* – to provide limited relief regarding financial instruments qualifying for hedge accounting in the lead up to IBOR reform. The Board made further tentative decisions at its March meeting clarifying how the initial relief would be applied and when it would end.

When would the relief apply?

The Board stated its intention that applying the targeted relief would not be a choice. Rather, the relief would be applied to all affected new and existing hedging relationships of interest rate risk on a mandatory basis.

This means that companies would be required to disclose the extent of the impact of the targeted relief on their affected hedging relationships for annual periods beginning on or after 1 January 2020.

When would the relief end?

Uncertainty with respect to IBOR cash flows may persist for a long time and vary across jurisdictions. For example, the Board discussed how the presence of fall-back clauses and amendments to contractual terms may remove some – but possibly not all – of the uncertainty around the timing and amount of IBOR cash flows.

The Board tentatively agreed that – in most cases – the proposed initial relief would end at the earlier of when:

- the uncertainty over the timing and amount of the resulting cash flows no longer exists; and
- the hedging relationship is terminated.

However, the relief requiring risk components to be separately identifiable at inception of the hedging relationship but not subsequently would always be applied until the hedging relationship is terminated.

Questions remain about whether the end of this first-phase relief will trigger de-designation – these concerns were not addressed at the meeting. The staff has indicated that amending hedge documentation for changes in the hedged item or hedged risk will be covered in the second phase of the Board's **IBOR reform project**.

What was clarified?

As discussed at the February meeting, the Board's proposed targeted relief is intended to apply to a company's prospective assessments and not affect measurement. A Board member clarified at the March meeting that a company performing a retrospective assessment under IAS 39 would assume that the cash flows used for measuring the hedged item are the *existing* IBOR-based cash flows.

Have your say

The Board intends to publish an exposure draft in May 2019, followed by a 45-day comment period. Therefore, it's important that preparers and users of financial statements read the Board's decisions and get ready to comment on the proposals to ensure that any concerns they may have are communicated to the Board.

The Board intends to issue final amendments to IFRS 9 and IAS 39 at the end of this year. Issues affecting financial reporting after new benchmark rates are in effect will be addressed in the second phase of the project.

Please watch this space for further updates and speak to your usual KPMG contact to find out more about the Board's deliberations.