Accounting & Auditing Update

FASB Proposed Accounting Relief for Contracts Modified Under LIBOR Rate Reform

By Jonathan Zuckerman, CPA, Samuel E. Botta, CPA and Kathleen A. Mills, CPA

The London Interbank Offered Rate (LIBOR) is one of the most commonly used benchmark interest rates for derivative and other commercial agreements; however, after 2021, financial institutions that currently report the information used to set LIBOR will no longer be required to do so. Various regulators, both domestic and international, are currently working on identifying an alternative reference rate, such as the Secured Overnight Financing Rate (a U.S. Treasury rate that is more risk-free) to replace LIBOR. As a result of this rate reform, contracts which will replace LIBOR as a reference rate with an alternative rate will require modification.

Proposed FASB ASU

Recently, the Financial Accounting Standards Board (FASB) issued a proposed Accounting Standards Update (ASU) in light of the forthcoming market transition from the use of LIBOR and other interbank offered rates to alternative rates. This proposed ASU will affect entities that are party to financial contracts, such as derivative contracts and variable interest rate debt agreements, that currently use the LIBOR rate and other interbank offered rates as a benchmark.

Effect of Proposal on Financial Reporting

The FASB's proposal will provide relief and alleviate the burden for entities that are party to financial contracts which will require modification resulting from the reference rate reform. Under this proposal, entities may elect to account for a modified contract affected by the rate reform as an existing contract, assuming certain criteria are met, rather than applying certain modified contract accounting typically required under US GAAP. Therefore, entities would not have to make other reassessments or remeasurements that would otherwise be required if the transaction was recorded as a derecognition of a contract and the initial recognition of a new contract.

Changes to critical terms of hedging instruments (i.e., a change to the reference rate used) – which fall within the scope of this proposed guidance – would not result in the dedesignation of the hedging relationship and entities would be able to continue to apply hedge accounting.

The proposed guidance would only apply to contracts which are modified to directly replace (or have the potential to replace) LIBOR or another reference rate that is expected to be discontinued as a result of reference rate reform and would not apply to other contract modifications which are unrelated to the replacement of a reference rate.

A link to the FASB's proposal can be found here.

Future Considerations

If your entity is currently party to a financial contract, particularly a contract that expires after the year 2021, that utilizes LIBOR or a similar offered interbank rate as a benchmark, we recommend that you contact your financial institution to determine the potential effects from the rate reform on the current terms of the agreement. Regulators and financial experts highly recommend for entities to treat the discontinuation of the use of the LIBOR rate in financial contracts beyond 2021 as a very highly probable event.

Effective Date of Proposed Guidance

The amendments in this proposed guidance would be applied up until January 1, 2023, one year after the expected discontinuation of the LIBOR rate.

Contact Us

Should you have any questions regarding this proposed ASU, please contact the partner in charge of your account or:

Jonathan Zuckerman, CPA
Partner
jzuckerman@pkfod.com | 646.699.2842

Samuel Botta, CPA
Senior Manager
sbotta@pkfod.com | 646.699.2857

Kathleen Mills, CPA
Senior Manager
kmills@pkfod.com | 646.699.2886

About PKF O'Connor Davies

PKF O'Connor Davies, LLP is a full-service certified public accounting and advisory firm with a long history of serving clients both domestically and internationally. With roots tracing to 1891, eleven offices in New York, New Jersey, Connecticut, Maryland and Rhode Island, and more than 700 professionals, the Firm provides a complete range of accounting, auditing, tax and management advisory services. PKF O'Connor Davies is ranked 29th on *Accounting Today*'s 2019 "Top 100 Firms" list and is recognized as one of the "Top 10 Fastest-Growing Firms." PKF O'Connor Davies is also recognized as a "Leader in Audit and Accounting" and is ranked among the "Top Firms in the Mid-Atlantic," by *Accounting Today.* In 2019, PKF O'Connor Davies was named one of the 50 best accounting employers to work for in North America, by *Vault*.

PKF O'Connor Davies is the lead North American representative in PKF International, a global network of legally independent accounting and advisory firms located in over 400 locations, in 150 countries around the world.