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IFRS Developments

IASB considers IFRS IC Agenda Decision: cash received via electronic transfer

What you need to know

- In September and October 2022, the IASB (International Accounting Standards Board) considered the IFRS IC's AD on the accounting for cash received via electronic transfer as settlement for a financial asset.
- In September 2022, the IASB decided to explore narrow-scope standard setting as part of its post-implementation review of IFRS 9, rather than approving the AD.
- In October 2022, the IASB agreed to explore allowing an accounting policy choice to derecognise a financial liability before settlement date.
- As a consequence of these decisions, until and unless the IASB finalises an amendment to IFRS 9, we expect diversity in accounting practice to continue.

Introduction

At its meeting on 22 September 2022, the International Accounting Standards Board (the IASB or the Board) considered the IFRS Interpretations Committee's (IFRS IC) agenda decision (AD) on *Cash Received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9 Financial Instruments).* The AD, which is discussed below, addresses the recognition of cash received via an electronic transfer system as settlement for a trade receivable.

The IASB considered the discussions of the IFRS IC and the comments of respondents' and agreed to explore narrow-scope standard setting with the aim to:

- Reduce the costs of applying the general recognition and derecognition requirements in IFRS 9 in accounting for payments an entity makes or receives as settlement for financial assets or financial liabilities, but
- Not to significantly reduce the usefulness of the information that would result from the consistent application of these requirements.[1]

At its meeting on 19 October 2022, the IASB agreed to explore amending IFRS 9 to permit the derecognition of a financial liability before settlement date, if specific criteria are met. This would potentially be an accounting policy choice for financial liabilities.

The IASB will consider the proposal further at a future meeting, including the form that any narrow-scope standard-setting would take.

How we see it

The IASB's decision in September 2022 to explore narrow-scope standard setting means the IASB neither agreed nor disagreed with the IFRS IC AD. Consequently, until and unless the IASB finalises an amendment to IFRS 9, we expect diversity in accounting practice to continue.

[1] IASB Staff Paper 12A, September 2022, paragraph 51.

Building a better working world

The agenda decision

The submission received by the IFRS IC, which is the subject of the AD, was first considered in September 2021 and presents the following fact pattern:

- The electronic transfer system has an automated settlement process that takes three working days to settle a cash transfer. All cash transfers made via the system are, therefore, settled (deposited in the recipients' bank account) two working days after they are initiated by the payer.
- An entity has a trade receivable with a customer. At the entity's reporting date, the customer has initiated a cash transfer via the electronic transfer system to settle the trade receivable. The entity receives the cash in its bank account two days after the reporting date.

The IFRS IC was asked to provide guidance on whether the entity should derecognise the trade receivable and recognise cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is settled (after its reporting date).

The IFRS IC observed that if the entity's contractual right to receive cash from the customer expires only when the cash is received, the entity would derecognise the trade receivable on the transfer settlement date (the date it receives the cash in its bank account). Therefore, it is only once cash is deposited with the bank that the entity would have a right to obtain cash from the bank. Consequently, the entity recognises cash as a financial asset on the transfer settlement date, and not before. This formed the basis for the IFRS IC AD, which the IFRS IC confirmed in June 2022 and was considered by the IASB in September 2022.

Whilst the fact pattern discussed by the IFRS IC is intentionally narrow in considering the derecognition of a trade receivable, in the papers for the September 2022 IASB meeting, the IASB staff acknowledged that as a result of the AD, entities may need to change their practices to comply with IFRS 9 for other fact patterns. This could include other payment methods such as cheques, and the derecognition assessment of liabilities, in addition to receivables.[2]

Cost benefit analysis

The IFRS IC reached a tentative agenda decision (TAD) in September 2021, which was open for comment until the end of November 2021. The IFRS IC received 27 responses, many of which commented that the potential outcomes from finalising the TAD could be problematic. These included that it could:

- Cause undue disruption to long-standing accounting practices, such as the accounting for cheques paid and received and the use of a bank reconciliation to arrive at the cash used for financial reporting purposes
- Have unintended consequences on the accounting for other payment methods, including payments by cheque or credit card and for payments to settle financial liabilities such as trade payables
- Be costly and complex to apply in terms of adapting systems and processes and undertaking a legal analysis in multiple jurisdictions and for different payment methods in order to determine when the rights to cash flows expire

Nevertheless, the IASB staff identified the following potential benefits to financial reporting as a result of applying the AD:

- It would reduce diversity in accounting for the fact pattern in the IFRS IC AD with regard to when to derecognise trade receivables and recognise cash

  And

[2] IASB Staff Paper 12A, September 2022, paragraph 39.

- Applying the general recognition and derecognition requirements in IFRS 9 would result in useful information for investors

Whether the benefits outweigh the costs will form part of the IASB's analysis before deciding on any new IFRS requirements. The IASB's decision to explore narrow-scope standard setting was informed by the Staff's recommendation to develop a solution that would help entities apply IFRS 9 without significantly reducing the decision usefulness of information for investors.

How we see it

Whilst there is an initial appreciation of the potential effects of finalising the AD, there is not full knowledge of the legal and operational details of all the payment systems that could be affected. Exploring narrow-scope standard setting provides entities with the opportunity to build the required knowledge needed to implement any changes required to their systems, processes and controls, in a targeted way.

The accounting policy choice being explored by the IASB could limit the impact of the AD for financial liabilities. However, if the AD is ultimately agreed, it could impact existing practices on accounting for financial assets.

Narrow scope standard setting

The staff recommended that narrow-scope standard setting should not simply allow entities to retain current practices that are not compliant with IFRS 9. Rather, the objective of standard setting could include:

- Helping entities to determine when the contractual rights and obligations to receive or deliver cash expire (or are extinguished); and
- Allowing entities to retain current accounting practices in specified situations, thereby reducing the costs they would otherwise incur to comply with IFRS.

As any standard setting would be narrow in scope, it would not amend the general recognition and derecognition requirements in IFRS 9. Consequently, it would not reduce the decision-usefulness of financial reporting and would not require entities who are already compliant with IFRS 9 to change their practices.

Given that a wide variety of payment systems across different jurisdictions could be affected, it could be necessary to specify the required characteristics of payment systems to which the new requirements would apply.

Any amendments resulting from the narrow-scope standard setting would follow the normal due process for finalising new IFRS requirements. This would include further Board discussions, the publication of an exposure draft, a comment period, and then publication of the final amendment with an effective date sometime in the future (usually at least 12 months). This would afford time for the IASB to better understand existing accounting treatments, how they have arisen and whether it is appropriate for them to be accommodated in a final amendment.

How we see it

If the IASB's decision to explore narrow-standard setting results in amendments to IFRS, entities will be able to follow the development of the new requirements to understand how they will affect them and plan for their implementation. This will allow any changes required to comply with IFRS to be implemented in a controlled fashion.

Cash and cash equivalents

A number of respondents to the TAD questioned the classification of cash and cash equivalents during the period between initiation of the payment and settlement of the trade receivable. Some respondents suggested that the IASB could change the definition of cash equivalents to include cash-in-transit.

This and similar questions in relation to the classification of cash were outside the scope of the IFRS IC's deliberations, which focused on the general recognition and derecognition requirements in IFRS 9 for payments made or received as settlement for financial assets or financial liabilities.

In April 2022, the IASB added a project to its research pipeline on the statement of cash flows and related matters, although the project is not yet active. This could in future include a discussion of what meets the definition of cash and cash equivalents. In the meantime, the IASB does not intend to discuss the matter further.

How we see it

The treatment of cash and cash equivalents in the context of the submission to the IFRS IC is important and will need to be clarified at some point in the future. This is necessary to reduce the potential for diversity in practice. However, this will be addressed in time and is a lower priority project than the one related to the recognition and derecognition of financial assets and financial liabilities with respect to cash payments and receipts.

Exploring an accounting policy choice for financial liabilities

At its October 2022 meeting, the IASB agreed to explore the possibility of allowing entities to make an accounting policy choice to derecognise a financial liability before the settlement date when using an electronic transfer system, if all of the following conditions are met[3]:

- The entity is irrevocably committed to the cash payment and therefore, has effectively lost control of the cash
- The initiation and completion of the cash transfer takes place within a short timeframe as established by market convention for such electronic payments

  And
- Completion of the cash transfer is subject only to an administrative process and not settlement risk of the entity

The IASB will consider whether the accounting policy choice for financial liabilities should be available for other transfer systems, such as the settlement of cheques.

For the derecognition of financial assets, which was the focus of the initial discussion by the IFRS IC, no change was proposed to the existing IFRS 9 requirements. This is because the most significant concerns stakeholders raised in response to the Committee's TAD related to the derecognition of financial liabilities. The IASB will, therefore, reconsider the AD in future.

How we see it

The proposed accounting policy choice for derecognising financial liabilities has similarities to the accounting election for a regular-way purchase and sale of financial asset, which has been available for many years and works well.

The fact that no similar accounting policy choice has so far been considered for the derecognition of financial assets may suggest that the IFRS IC AD, which focuses on financial assets, could ultimately be agreed by the IASB in the future. However, this will depend on the direction of the IASB's project in this area, which is still at an early stage.

[3] IASB staff paper 3C, October 2022, paragraph 41.

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ED None