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IFRS Developments

IFRS IC tentative agenda decision: cash received via electronic transfer

What you need to know

- On 15 September 2021, the IFRS IC reached a tentative agenda decision (TAD) on the accounting for cash received via an electronic transfer system.
- The TAD is open for public comment until 25 November 2021.
- For some entities, this could lead to major changes to their financial statements and reporting processes.
- The TAD, if finalised, is likely to come into effect during 2022.

Introduction

At its meeting on 15 September 2021, the IFRS Interpretations Committee (IFRS IC) reached a tentative agenda decision (TAD) on a submission concerning *Cash received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9 Financial Instruments).* The IFRIS IC tentatively concluded that existing IFRS provides an adequate basis to determine the accounting and, therefore, tentatively decided not to add a standard setting project to the work plan.

The IFRS IC will reconsider the TAD, including the reasons for not adding a standard-setting project, at a future meeting. The TAD is open for comment until 25 November 2021.

The TAD, if finalised, has the potential to change the accounting applied by many entities for the recognition of cash receipts and cash payments.

How we see it

Considering due process requirements, an IFRS IC agenda decision is unlikely to be finalised and published before the first quarter of 2022. If finalised unchanged, entities impacted will need to be prepared to change their existing practices, if conflicting with the agenda decision, on a timely basis.

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The fact pattern

The submission received by the IFRS IC 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).

Expiration of contractual cash flows

The IFRS IC's analysis focused on the IFRS 9 requirement that, except when an entity transfers a financial asset, a financial asset may only be derecognised when 'the contractual rights to the cash flows from the financial asset expire'.[1]

Applying this to the fact pattern, the trade receivable would be derecognised only when its contractual rights expire. Establishing when this has occurred is a legal matter, 'which would depend on the specific facts and circumstances including the applicable laws and regulations and the characteristics of the electronic transfer system'[2].

During the IFRS IC's discussions, it was highlighted a trade receivable cannot be derecognised during a payment process in the following two instances:

- If a payment to settle a trade receivable can be cancelled after it has been initiated
- If, in the event of default by the bank making the payment, the entity that holds the trade receivable can still demand payment from the customer

In the fact pattern described in the request, 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).

How we see it

For an entity that operates in multiple jurisdictions, obtaining the necessary legal opinions for all the settlement systems it uses, may be time and resource demanding.

[1] IFRS 9.3.2.3.
[2] *IFRIC Update*, September 2021.

Recognition of cash

IFRS 9 requires an entity to recognise a financial asset when, and only when, 'the entity becomes party to the contractual provisions of the instrument'.[3] In the fact pattern described in the request, the IFRS IC observed that it is only when cash is deposited in its bank account 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.

The IFRS IC also observed that, if the entity's contractual right to the cash flows from the trade receivable expires before the transfer settlement date, the entity would recognise any financial asset received as settlement for the trade receivable (for example, a right to receive cash from the customer's bank) on that same date. The financial asset, although not representing cash may, if the criteria are met, meet the definition of cash equivalents.[4] The entity would not, however, recognise cash (or another financial asset) received as settlement for a trade receivable before it derecognises the trade receivable.

Potential implications for other fact patterns

The IFRS IC's considerations, which were only applied to electronic transfer systems, are also potentially relevant to other settlement methods. Examples could include:

- A cheque received to settle a trade receivable which is capable of being cancelled for some time after it has been written or, which will not result in cash being credited to the recipient's bank account until the debtor's bank transfers the funds (such that the original trade receivable remains).
- A credit card that allows card holders to cancel payments to a merchant before they are settled.

In both examples, the entity's right to the cash in its bank account rather than the cash flow from the trade receivable, is only confirmed when the transfer has settled. Only then, assuming a similar analysis as in the TAD, does the entity have the contractual right to obtain cash from amounts deposited in its bank account.

How we see it

The TAD discusses the derecognition of a trade receivable and the recognition of cash. However, it may also be relevant to the derecognition of a financial liability.

In many jurisdictions, it has been long-established practice, for example, for amounts paid by cheque, to be deducted from cash and from trade payables when the cheque is dispatched. It may be necessary to revisit the basis for such practice if the agenda decision is finalised.

[3] IFRS 9.3.1.1.
[4] IAS 7.6.

In light of how well established certain accounting practices are in many jurisdictions, the impact of the TAD, if finalised, could be significant. Entities may need to make substantial changes to their payment, settlement and accounting systems, which would need to be carefully planned and managed.

How we see it

Entities should start to assess the potential consequences for them if the TAD is finalised. This includes understanding the possible effect on the cash flow statement, key ratios and liquidity measures such as net debt, and also on any lending covenants. If entities have particular concerns over the possible effects or if they disagree with the technical basis, they should take the opportunity to comment on the TAD.

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ED None