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PIR IFRS 9 *Classification and Measurement* - Exploring possible narrow scope amendments for electronic cash transfers
Issues Paper

Objective

1 To provide an update to EFRAG FR TEG on the IASB considerations for whether, and if so when, to take action on matters identified during a PIR and outline possible options for narrow-scope standard-setting to address the comments raised in respect of IFRS IC TAD on electronic cash transfers.

Background of the IFRS IC project

2 The IFRS Interpretations Committee (IFRS IC) received a request about the recognition of cash received via an electronic transfer system as settlement for a financial asset ('the TAD'). In the fact pattern described in the request:

(a) 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 recipient's bank account) two working days after they are initiated by the payer.

(b) 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 its reporting date.

3 The request asked whether the entity could 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).

IFRS IC's tentative agenda decision (Agenda Paper 6 – September 2021)

4 In the fact pattern described in the request, the IFRS IC concluded that, applying paragraphs 3.2.3[1] and 3.1.1[2] of IFRS 9, the entity:

(a) derecognises the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire; and

[1] Paragraph 3.2.3 of IFRS 9 states: "*An entity shall derecognise a financial asset when, and only when:*
(a) the contractual rights to the cash flows from the financial asset expire, or
(b) it transfers the financial asset as set out in paragraphs 3.2.4 and 3.2.5 and the transfer qualifies for derecognition in accordance with paragraph 3.2.6."

[2] Paragraph 3.1.1 of IFRS 9 states: "*An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument (see paragraphs B3.1.1 and B3.1.2). When an entity first recognises a financial asset, it shall classify it in accordance with paragraphs 4.1.1–4.1.5 and measure it in accordance with paragraphs 5.1.1–5.1.3. When an entity first recognises a financial liability, it shall classify it in accordance with paragraphs 4.2.1 and 4.2.2 and measure it in accordance with paragraph 5.1.1.*"

(b) recognises the cash (or another financial asset) received as settlement for that trade receivable on the same date.

5 The IFRS IC observed that the entity is neither purchasing nor selling a financial asset. Therefore, paragraph 3.1.2 of IFRS 9 – which specifies requirements for a regular way purchase or sale of a financial asset – is not applicable.

6 Furthermore, 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).

7 In addition, 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.

8 If an entity's contractual rights to the cash flows from the trade receivable expire before the transfer settlement date, the entity would recognise any financial asset receivable as settlement for the trade receivable. An entity would not however recognise cash (or another financial asset) received as settlement for a trade receivable before it derecognises the trade receivable.

9 The IFRS IC concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine when to derecognise a trade receivable and recognise cash received via an electronic transfer system as settlement for that receivable. Consequently, the IFRS IC tentatively decided not to add a standard-setting project to the work plan.

Respondents feedback

10 Although agreeing with the IFRS IC conclusion, the respondents highlighted the following concerns:

(a) cause undue disruption to long-standing accounting practices, such as the accounting for cheques and the performance of bank reconciliations;

(b) have unintended consequences on the accounting for other payments methods, such as payments made by cheques or credit cards, and for payments an entity makes to settle trade payables; and

(c) be costly and complex to apply, both in terms of (i) adapting systems and processes, and (ii) undertaking legal analysis to determine when rights to cash flows expire across different payment methods and jurisdictions.

11 Therefore, they suggested not to finalise the agenda decision or the issue to be addressed as part of the PIR of IFRS 9 or another standard-setting project.

IFRS IC and IASB discussions

12 In June 2022, after considering the feedback on the tentative agenda decision, the IFRS IC confirmed the analysis and conclusion in the TAD and voted to finalise the agenda decision. Nonetheless, IFRS IC members decided to report to the IASB respondents' comments on the potential outcomes of finalising the agenda decision (see Agenda Paper 3 for details).

13 At its September 2022 meeting (see Agenda Paper 8A and Agenda Paper 12A), the IASB considered the draft agenda decision and the concerns raised and tentatively decided to explore narrow-scope standard-setting as part of its post-implementation review (PIR) of IFRS 9 *Classification and Measurement*. As a result, the IASB was not asked whether they object to the agenda decision, as required by paragraph 8.7 of the IFRS Foundation Due Process Handbook.

Background of the EFRAG discussions

EFRAG FR TEG

14 The EFRAG FR TEG members discussed the topic in a closed session at the meeting on 13 July 2022 and made the following key comments:

(a) EFRAG FR TEG members agreed with the IFRS IC Staff technical analysis of the issue. Most of the members considered that it will reduce diversity in practice, improve comparability and provide more useful information to users.

(b) On the other hand, EFRAG FR TEG members acknowledged that in some cases of the long-established practices the application of TAD might result in the implementation costs which will not outweigh the benefits and that the informative value of the roll-over adjustments to the balance sheet numbers might be limited.

(c) EFRAG FR TEG members welcomed that the IASB discussion of the TAD was postponed to September which might give preparers 'sufficient time' referred to in *Due Process Handbook* to change their accounting policies.

(d) Members noted that the question of whether these 'cash in transit' balances represent cash equivalents and can be classified as such remained open and that defining it as 'cash' would solve the issue.

(e) Members acknowledged that cost-benefit argument cannot be used by the IFRS IC to determine whether to add a standard-setting project to the work plan. However, some members suggested to explore whether PIR process could not be a better place for it. However, they questioned why this issue was not raised during the PIR of IFRS 9 *Classification and Measurement* and what type of a standard setting should be requested.

EFRAG FRB

15 EFRAG FRB discussed the TAD in a closed session at its meeting on 14 July 2022. EFRAG FRB members made the following comments and suggestions:

(a) EFRAG FRB members agreed with the IFRS IC staff technical analysis on the issue but, on the other hand, believed that EFRAG should approach the matter from a broader angle, considering many different aspects such as cost-benefit and legal analysis. Members welcomed the IASB discussion of the TAD was postponed to September.

(b) An EFRAG FRB member **suggested including the issue in the next EFRAG FIWG meeting to better understand** whether or not the TAD had a **significant impact on implementation** or would **significantly change the accounting practice** in the financial sector of the European jurisdictions.

(c) Another EFRAG FRB member highlighted that the IFRS 9 were very difficult to apply in the current wording and that made this TAD different. He also mentioned that the costs of implementing the TAD will be significant and the benefits limited since in the current practice cash in transit is considered as 'cash or cash equivalents' only when it is virtually certain that the entity will receive the cash.

EFRAG FIWG

16 EFRAG FIWG members discussed the TAD at the meetings on 6 September and 25 October 2022 and provided the following comments:

6 September 2022

17 Although the members agreed with the IFRS IC technical analysis, they stressed that the TAD implementation might have significant consequences particularly on

the payment side, as the practice has been established to debit trade payables on the day the payment is initiated. Members saw less implications on the receiving side as normally the cash was recorded when received.

18 Members noted that the costs of changing systems could be very significant and suggested the IASB to consider some sort of practical expedient for the payment side of such transactions.

19 Members also noted that the TAD did not restrict the scope of its application and could potentially be extended to other payment methods such as cheques and credit cards and also beyond the settlements for goods and services.

20 The challenges of retrospective application of the TAD and a lack of guidance on cash in transit were highlighted.

25 October 2022

21 EFRAG FIWG members generally supported the IASB direction to go for accounting policy choice.

22 Members questioned however, the exact scope of the amendments: would it only relate to the liabilities side and would it be limited to the electronic cash transfers. Members noted that for cheques the proposed solution would not work.

23 Members also questioned the transition requirements in case the scope of the amendments would only relate to the electronic cash transfers. In one member's view, it was unclear if the TAD would still be applicable to other type of cash disbursement transactions and if it should be adjusted retrospectively.

EFRAG IAWG

24 EFRAG IAWG discussed this topic at its meeting on 3 November 2022. The update from this discussion will be provided to EFRAG FR TEG orally.

The IASB October discussion

PIR criteria

25 The IASB staff applied the PIR criteria to the TAD and acknowledged that diversity in practice and the potential outcomes from applying the derecognition requirements to electronic cash transfers may partially result in lower benefits to the users of financial statements.

26 The IASB staff also acknowledged the respondents' concerns about the potential for disruption to long-standing accounting practices in many jurisdictions and the costs entities may incur to comply with the requirements in IFRS 9.

27 As a result, the IASB staff concluded that exploring potential narrow-scope standard-setting is appropriate.

28 The IASB staff concluded that the matter was pervasive and had substantial consequences but before concluding on the timing and priority of any action, the IASB staff suggested to first explore what the potential objective and scope of any standard-setting might be.

The scope of a standard setting

29 In the IASB staff view there is no evidence to justify a fundamental change to the derecognition requirements in IFRS 9.

30 Therefore, a narrow-scope standard-setting should suffice with an objective to:

(a) continue to provide useful information to users of financial statements about the amount, timing and uncertainty of an entity's future cash flows;

(b) reduce, where possible, the costs of applying the general recognition and derecognition requirements in IFRS 9; and

(c) maintain the principle-based nature of the derecognition requirements in IFRS 9.

31 The IASB staff proposed two potential narrow-scope standard-setting options:

(a) clarification of particular aspects of the derecognition requirements in IFRS 9; or

(b) development of an accounting policy choice to permit derecognition of a financial liability before the settlement date when specified criteria are met.

Clarification of particular aspects of the derecognition requirements of IFRS 9

32 The objective of such a potential clarification would be to clarify when the contractual rights to the cash flows from a financial asset expire (paragraph 3.2.3(a) of IFRS 9) or a financial liability are extinguished (paragraph 3.3.1 of IFRS 9).

33 Although the recognition-derecognition criteria in IFRS 9 are generally symmetrical, there is not necessarily symmetry in the timing of recognition and derecognition, each entity assesses it from its own perspective.

34 In the IASB staff view the challenge for any potential narrow-scope amendment to IFRS 9 is to:

(a) maintain symmetry in the requirements for derecognition of financial assets and financial liabilities; but at the same time

(b) establish a principle whereby the contractual rights and obligations to receive or deliver cash or another financial asset could expire (or be extinguished) before the transfer settlement date.

35 Thus, the scope of the project could become wider, because:

(a) any potential clarification of the derecognition requirements for financial liabilities would need to be considered separately for financial assets, because of the separate derecognition requirements; and

(b) any potential clarification could not be limited to only electronic cash transfers or even cash more broadly; other settlement transactions and delivery of other financial assets should also be considered. This is because the definitions of financial assets and financial liabilities refer to contractual rights and obligations to receive or deliver cash or another financial asset.

36 A clarification of when contractual rights to cash flows expire or are extinguished could potentially lead to a fundamental change to the derecognition requirements in IFRS 9.

37 However, the feedback from PIR of IFRS 9 confirmed that there are no fundamental questions about the clarity and suitability of those derecognition requirements.

38 Therefore, should the IASB go this route, it should assess this project against other priorities in its workplan.

Accounting policy choice when specified criteria are met

39 This approach could take the form similar to the accounting policy choice for regular way transactions and could potentially allow current accounting practices mentioned by stakeholders to be continued in specified circumstances.

40 The IASB staff did not consider it useful to explore all the world-wide cash payment mechanisms but considered it possible to develop a principles-based solution by focussing on the characteristics of a payment that would not be considered

inconsistent with the derecognition requirements in IFRS 9, but that might resolve the timing difference.

41 Therefore, it might be helpful to consider whether an entity has lost control of cash when initiating an electronic payment. To determine it, the following questions could be considered:

(a) whether the entity could cancel or withdraw the electronic cash transfer instruction before it is complete;

(b) whether the completion of the payment is subject to settlement risk of the entity (i.e., the entity's credit risk);

(c) whether the delay between initiation and completion of the payment is purely an administrative process based on the market convention for the particular payment system; and

(d) the timeframe for completion of the payment instruction in using the specific electronic cash system and what happens in the event of failure by the bank to complete the payment.

42 Considering these characteristics, once an entity has initiated a payment instruction that cannot be withdrawn, the cash is no longer available for use by the entity (even though it might still be in the entity's account) and therefore the entity has lost control of its cash.

43 A potential accounting policy choice would permit an entity **to derecognise a financial liability before the settlement date** when using an electronic transfer system if all the following criteria are met:

(a) the entity is irrevocably committed to the cash payment and therefore has effectively lost control of the cash;

(b) the initiation and completion of the cash transfer takes place within a short timeframe as established by market convention for such electronic payments; and

(c) completion of the cash transfer is subject only to an administrative process and not settlement risk of the entity.

The IASB staff preliminary views

44 The IASB staff considers that the first option will require fundamental changes in IFRS 9 derecognition requirements and might have unintended consequences. Such an amendment will not qualify as a narrow-scope amendment and will require more time and resources.

45 The accounting policy choice that would permit the derecognition of a financial liability before the settlement date when using an electronic cash transfer can be dealt within a limit of a narrow-scope amendment. This exception from the general derecognition requirements in IFRS 9:

(a) could be operable if the scope of such amendment is sufficiently narrow and limited to specified circumstances;

(b) would mitigate the risk of unintended consequences by developing appropriate criteria to be met; and

(c) would not significantly reduce the usefulness of the information that would result from the consistent application of these requirements. However, such an approach would not necessarily reduce the costs of applying the derecognition requirements for all entities because the accounting policy choice would be available only when specified criteria are met.

46 On balance, the accounting policy choice is a preferred option to ensure a timely and effective response to the concerns raised while avoiding unintended consequences.

IASB members views

47 The IASB members supported the IASB staff recommendation for the accounting policy choice option. The majority also supported the criteria and the notion of control although not existing in IFRS 9.

48 The IASB members stressed the importance of having a narrow scope to avoid unintended consequences and the application to other types of transactions by analogy. Some members proposed to clarify to what transactions this policy choice will not apply. However, other members sought whether other types of disbursements of financial instruments (e.g., the cheques, etc) should be included, but in this case the criteria should be adjusted.

49 One member suggested to replace the word ‘committed’ by ‘initiated the transfer’ for more clarity.

50 Members also suggested to define transition requirements.

The EFRAG Secretariat assessment

51 The EFRAG Secretariat appreciates the IASB efforts to address the diversity in practice regarding the derecognition of financial liabilities.

52 It should be noted that IFRS IC initial submission referred to the derecognition of trade receivable before the cash arrived at the bank account but after the payment was initiated by a counterparty (see paragraph 2 of this paper). However, the respondents extended the interpretation of the TAD to the liabilities side and other payment methods.

53 The EFRAG Secretariat considers that developing an accounting policy choice is a precedent for the IFRS 9 and this solution will not improve the comparability, although it might permit keeping the existing accounting practices and thus will not create additional costs for affected entities.

54 However, the scope of such accounting policy choice should be clearly defined. If the scope will be narrow and will only cover electronic cash transfers, then other payment methods (such as cheques and credit cards) will not benefit from it and the questions of whether the TAD conclusion will be applicable to them will remain. This approach would probably not significantly reduce the costs for the affected entities.

55 If the scope will be larger to include cheques, credit cards and eventually other types of disbursements, then the criteria developed by the IASB staff (see paragraph 41 of this paper) should be adjusted to capture the specificities of other payment methods.

56 If the scope will be even larger to include the assets side, then such an exception will probably not meet the definition of a narrow-scope amendment and will require more time and resources to complete.

57 The IASB states that this narrow-scope amendment introduces an exception from the general derecognition requirements in IFRS 9. The EFRAG Secretariat notes that introduction of an exception and an accounting policy choice is in conflict with the aim of maintaining the principle-based nature of the derecognition requirements in IFRS 9.

58 The IASB solution also introduces the concept of control to define the criteria for an exception. Currently ‘control’ is a secondary step compared to ‘transfer of the risks and rewards’ (paragraph 3.2.6 of IFRS 9) in determination of when a financial asset

should be derecognised. This is an important change to IFRS 9 that would require careful consideration.

59 The proposed criteria for an accounting policy choice also require careful consideration:

(a) ‘Irrevocably committed’, ‘effectively lost control’, ‘within a short time frame’ require certain degree of judgement and may be subject to interpretations.

(b) To determine whether a completion of a transaction is subject to ‘settlement risk of the entity’ can require complex legal analysis, there can always be some degree of a risk.

(c) The ‘administrative process’ although seems to be a common understanding but might need to be defined.

60 The EFRAG Secretariat also notes the IASB decision to include this narrow scope amendment, together with the proposed amendments to IFRS 7 *Financial Instruments: Disclosures* for equity instruments and other comprehensive income in the *Amendments to the Classification and Measurement of Financial Instruments* project which replaces the fast-track *Contractual Cash Flow Characteristics* project. The EFRAG Secretariat expresses concerns that inclusion of additional topics might delay the completion of the whole project and highlights that a solution for the financial instruments with ESG features remains a priority.

Questions for EFRAG FR TEG

61 Does EFRAG FR TEG agree with the IASB staff recommendation?

62 What are EFRAG FR TEG views on the scope and the criteria of the proposed accounting policy choice?

63 Does EFRAG FR TEG have any other suggestions on how to approach this issue?

64 Does EFRAG FR TEG have any comments on the EFRAG Secretariat assessment?