IFRS 9: Cash Received via Electronic Transfer as Settlement for a Financial Asset

Extract, IFRS® Discussion Group Report on the Meeting – December 15, 2021

The IFRS® Interpretations Committee (the Interpretations Committee) received a request about the recognition of cash received via an electronic transfer system as settlement for a financial asset.

In the Fact Pattern described in the submission:

- 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.
- 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 request asked whether the entity could derecognize the trade receivable and recognize cash on the date the cash transfer is initiated (its reporting date), rather than on the date the cash transfer is received. The Interpretations Committee discussed this issue at its September 2021 meeting. Subsequent to the meeting, the Interpretations Committee published a tentative agenda decision on this issue.

The Group discussed the analysis included in this tentative agenda decision as summarized below.

Issue 1: Should the entity derecognize the trade receivable and recognize cash on the date the cash transfer is initiated rather than on the date the cash transfer is settled?

Analysis

Derecognition of the trade receivable

Except when an entity transfers a financial asset, paragraph 3.2.3 of IFRS 9 *Financial Instruments* requires an entity to derecognize a financial asset (trade receivable) when the contractual rights to the cash flows from the financial asset expire. Therefore, applying this paragraph to the Fact Pattern, the entity derecognizes the trade receivable on the date on which its contractual rights to the cash flows from the trade receivable expire.

The Interpretations Committee noted that determining the date on which the entity's contractual rights to those cash flows expire is a legal matter, which would depend on the specific facts and circumstances; applicable laws and regulations; and the characteristics of the electronic transfer system. In the Fact Pattern, if the entity's contractual right to receive cash from the customer expires only when the cash is received, the entity would derecognize the trade receivable on the transfer settlement date.

Recognition of cash (or another financial asset)

Paragraph 3.1.1 of IFRS 9 requires an entity to recognize a financial asset "when, and only when, the entity becomes party to the contractual provisions of the instrument." In the Fact Pattern, the entity is party to the contractual provisions of an instrument- its bank account- under which it has the contractual right to obtain the cash from the bank for amounts deposited with that bank. As a result, 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 would recognize cash on the transfer settlement date.

The Interpretations Committee observed that if an entity derecognizes the trade receivable prior to recognizing cash, the entity will recognize any financial asset received as settlement for the trade receivable (e.g., a right to receive cash from the customer's bank) on that same date.

The Group's Discussion

Group members agreed with the analysis.

Some Group members noted that the analysis only addresses the Fact Pattern and may not apply to other transactions involving the settlement of trade receivables. Therefore, entities need to carefully review the characteristics of their payment processing systems, the terms and conditions of the agreements with their counterparties, and the applicable laws and regulations in determining when to derecognize a trade receivable and recognize cash.

Issue 2: Practical implications of the tentative agenda decision

The Group first considered the current practice in Canada when accounting for the settlement of a financial asset via an electronic transfer and discussed whether such practice is in line with the thought process outlined in the tentative agenda decision and its conclusion.

The Group's Discussion

Several Group members observed that in practice most entities derecognize trade receivables and recognize cash when electronic transfers are settled, which aligns with the conclusion of the tentative agenda decision. In addition, one Group member observed that in practice, customers often do not notify their suppliers that the cash has been sent. Therefore, suppliers only know their accounts receivable are settled when the cash has been deposited in their bank account.

One Group member observed that most electronic transfers within North America are settled within the same business day. However, international electronic transfers sometimes take multiple days to settle. The accounting for these transactions varies in practice, depending on the terms of the agreement and the characteristics of the payment processing system in the specific jurisdiction.

The Group then discussed the following practical implications of this tentative agenda decision:

Settlement of a financial liability via an electronic transfer

Analysis

The tentative agenda decision does not address the accounting implications of a settlement of a financial liability (an account payable) via an electronic transfer.

Paragraph 3.3.1 of IFRS 9 states that "an entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished - i.e. when the obligation specified in the contract is discharged or cancelled or expires." Applying this paragraph, the customer in the Fact Pattern should assess when the financial liability should be derecognized, which is the moment the obligation is discharged.

Practical implications on other payment systems and settlement forms

Analysis

In practice, various agreements may exist between entities and their processors. The settlement mechanisms may also vary depending on factors such as the payment processor's internal process. As a result, this tentative agenda decision can potentially have broader practical implications than the Fact Pattern the Interpretations Committee considered.

In addition, this tentative agenda decision suggests entities may need to review their approach to accounting for transactions effected via a broad range of payment systems and for more traditional forms of settlements, for example, the accounting for the issuance of cheques that have a delay of processing by a financial institution.

The Group's Discussion

Most Group members agreed that the thought process discussed in this tentative agenda decision can also be applied to the settlement of a financial liability. However, they also identified several practical implications that entities will need to consider as part of their analysis.

Some Group members observed that the majority of entities' accounting systems are set up to derecognize accounts payable when an electronic transfer is initiated or when a cheque for payment is issued. Any payments in transit at the reporting date are tracked by the bank-reconciliation process. This process and the related controls are well established in practice. Several Group members observed that changing the way that payments in transit are accounted for could require significant changes to the bank reconciliation process and related controls.

Some Group members observed that entities might need to consider many possible factors in determining when to derecognize a financial liability. For example, an entity may need to consider whether it has the legal right to cancel a cheque or electronic payment before it is deposited in its supplier's bank account. Entities may also need to consider the terms of their supplier agreements, characteristics of their payment processing systems, and the applicable laws and regulations in the jurisdictions in which they operate. Depending on an entity's nature and circumstances, this may require a significant effort to determine when a financial liability should be derecognized.

One Group member noted that the tentative agenda decision does not specifically address the derecognition of credit card payment receivables. However, this issue may be material, especially for retailers.

Some Group members noted that multi-day settlement periods may become rarer as technology shifts toward real-time payment settlement systems and blockchain transactions. As a result, this issue may become less significant over time.

Issue 3: Implementation of the agenda decision

Analysis

If the Interpretations Committee finalizes this tentative agenda decision, an entity should consider whether its accounting policy needs to be changed to comply with the agenda decision. Any change in accounting policy is required to be applied retrospectively using guidance in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The entity is entitled to "sufficient time" to implement an Interpretations Committee's agenda decision. It should refer to the IASB article, "Agenda decisions – time is of the essence" and the Due Process Handbook, Sections 8.2-8.7 for guidance on the timely implementation of agenda decisions.

The Group's Discussion

Given the tentative agenda decision was not finalized in 2021, Group members agreed that entities should not be required to implement this tentative agenda decision for December 31, 2021, year-ends.

Several Group members noted that interpretation of "sufficient time" to implement this agenda decision depends on factors such as the number and the complexity of entities' settlement systems with their payment processors and individual agreements with their customers. To properly analyze the impact, entities may need to consult with their legal counsel. One Group member commented that certain sectors, such as financial institutions, may need more time to implement this agenda decision given the nature of their business.

Some Group members also highlighted the need to consider the disclosure requirements in IAS 1 *Presentation of Financial Statements* and IAS 8 when implementing this tentative agenda decision, if finalized after 2021. They noted that paragraph 122 of IAS 1 requires entities to disclose "the judgments… that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements." In addition, while paragraph 30 of IAS 8 does not specifically require entities to disclose information about changes in their accounting policies resulting from agenda decisions, similar disclosures may provide relevant information to users on the expected timing and the possible impact that applying the agenda decision will have on their financial statements.

The purpose of the Group's discussion is to highlight the analysis in the tentative agenda decision and discuss the practical implications that this tentative agenda decision can have on the accounting for entities' various payment processes. One Group member noted that the AcSB has submitted a response letter to this tentative agenda decision. The Interpretations Committee will discuss the comment letters received and decide on the next steps at a future meeting. Accordingly, the Group will monitor the outcome of this issue and may revisit this issue at another meeting. No further action was recommended to the AcSB.