IFRS Accounting

Staff paper

Agenda reference: 3C

IASB® meeting

Date	**October 2022**
Project	**Post-implementation review of IFRS 9─Classification and Measurement**
Topic	**Exploring possible narrow scope amendments for electronic cash transfers**
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Purpose of this meeting

1. In September 2021 the IFRS Interpretations Committee (Committee) received a request about the recognition of cash received via an electronic transfer (payment) system as settlement for a financial asset applying IFRS 9 *Financial Instruments* and published a tentative agenda decision.

2. In the fact pattern described in the request, the Committee concluded that, applying paragraphs 3.2.3(a) and 3.1.1 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

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

3. The Committee concluded that the principles and requirements in IFRS Accounting 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 Committee tentatively decided not to add a standard-setting project to the work plan.

4. Many respondents suggested that the Committee not finalise the agenda decision and refer the matter to the IASB.

5. In June 2022, after considering the feedback on the tentative agenda decision, the Committee confirmed the analysis and conclusion in the tentative agenda decision and voted to finalise the agenda decision. Nonetheless, Committee members decided to report to the IASB respondents' comments on the potential outcomes of finalising the agenda decision. Agenda

paper 3 for the June 2022 Interpretations Committee meeting summarised respondents' comments and staff analysis on the following main areas:

(a) disruption to long-standing practices;

(b) unintended consequences for other fact patterns; and

(c) the costs and complexity of applying the agenda decision.

6. The IASB considered the draft agenda decision and the concerns raised (as discussed in paragraph 5 of this paper) at its September 2022 meeting 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.*

7. The purpose of this paper is to consider this matter against the IASB's criteria for whether, and if so when, to take action on matters identified during a post-implementation review and outline possible options for narrow-scope standard-setting to address the comments raised.

8. This paper provides:

(a) summary of the PIR criteria;

(b) summary of the requirements in IFRS 9 for recognition and derecognition;

(c) objectives of narrow-scope standard-setting;

(d) staff analysis of possible narrow-scope standard-setting;

(e) staff preliminary views; and

(f) question for the IASB.

Summary of the PIR criteria

9. As discussed in Agenda paper 8A for the September 2022 meeting, the IASB considers whether to take action on matters identified in PIRs and the prioritisation of those matters, applying specific criteria. The fact pattern referred to the IASB highlighted that a number of stakeholders have raised questions about the potential outcomes of applying, in particular, the derecognition requirements in IFRS 9 to the settlement of a financial asset or financial liability via an electronic cash transfer system.

10. To assist the IASB in exploring whether a narrow-scope standard-setting solution could be developed, we have first assessed the matter against the relevant PIR criteria:

Is there evidence that:	Staff assessment
(a) there are fundamental questions (ie 'fatal flaws') about the clarity and suitability of the core objectives or principles in the new requirements; or	**No** The Interpretations Committee concluded, and stakeholders agreed (or did not disagree) that the principles and requirements in IFRS 9 provide an adequate basis for an entity to determine when to derecognise a trade receivable. Furthermore, feedback on the PIR, including consultations with ASAF, did not provide evidence that there are fundamental questions about the clarity and suitability of the derecognition requirements in IFRS 9.[1]
(b) the benefits to users of financial statements of the information arising from applying the new requirements are significantly lower than expected (for example, there is significant diversity in application); or	**Partially** The feedback on the PIR did not provide evidence that (i) the benefits to users of financial statements from applying the derecognition requirements in IFRS 9 are significantly lower than expected or (ii) there is significant diversity in practice overall. However, the staff acknowledge the diversity in practice identified by stakeholders as part of the Committee's work on the cash transfer request and the potential outcomes from applying the

[1] Please also refer to Agenda Paper 3A of the March 2022 IASB meeting and the July 2022 ASAF summary.

Is there evidence that:	Staff assessment
	derecognition requirements to electronic cash transfers.
(c) the costs of applying some or all of the new requirements and auditing and enforcing their application are significantly greater than expected (or there is a significant market development since the new requirements were issued for which it is costly to apply the new requirements consistently).	**Partially** The feedback on the PIR did not provide evidence that the costs of applying, auditing and enforcing the derecognition requirements in IFRS 9 are significantly greater than expected. However, as stated in Agenda Paper 12A for the September 2022 IASB meeting, we acknowledge 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.

11. Based on the above assessment against the PIR criteria, we continue to be of the view that exploring potential narrow-scope standard-setting is appropriate.

Prioritisation of the matters on which to take action

12. The following table sets out each of the factors the IASB considers in assessing the priority for taking action in response to findings raised in a PIR and the staff assessment against these factors.

13. Depending on the assessment the priority of the matters arising will be classified as high, medium, or low priority.

Does evidence gathered during the PIR indicate that:	Staff assessment
(a) the matter has substantial consequences?	**Yes** As noted in Agenda Paper 12A for the September meeting, stakeholders have raised concerns about the potential for disruption to long-standing accounting practices, unintended consequences for other fact patterns and the costs of applying the requirements. However, as noted in paragraph 35 of that paper, the staff note that disruption to long-standing practices is not in itself a reason for undertaking standard-setting. Nonetheless, we acknowledge these potential outcomes and associated costs of applying the requirements.
(b) the matter is pervasive?	**Yes** As noted in comment letters on the tentative agenda decision and the additional outreach performed, stakeholders are of the view that the matter could affect electronic cash transfers for both payments and receipts.
(c) the matter arises from a financial reporting issue that can be addressed by the IASB or the Interpretations Committee? and	**It depends** Whether the matter can be addressed by the IASB in an efficient manner will depend on the scope of any potential narrow-scope standard-setting. The wider the scope of such standard-setting, the longer such a project would take and the IASB would need to consider the priority of this potential project in relation to its other standard-setting priorities. The more narrowly-defined the scope of

Does evidence gathered during the PIR indicate that:	Staff assessment
	such standard-setting, the greater the likelihood of developing a solution in an efficient manner'.
(d) the benefits of any action would be expected to outweigh the costs. To determine this, the IASB would consider the extent of disruption and operational costs from change and the importance of the matter to users of financial statements.	**It depends** Whether the benefits of any action the IASB takes in this regard are expected to outweigh the costs will depend on the scope of any potential narrow-scope standard-setting. While addressing the matter would provide clarity about the application of the derecognition requirements in IFRS 9, any standard-setting activity invariably leads to costs and disruption for at least some stakeholders. The wider the scope of any potential standard-setting, the greater the potential for costs and disruption, including the risk of unintended consequences. The narrower the scope of any such standard-setting, the greater the potential for less cost and disruption and the lower the risk of unintended consequences.

14. Before concluding on the timing and priority of any action the IASB might decide to take, we view it as important to explore what the potential objective and scope of any standard-setting might be.

Summary of the requirements in IFRS 9 for recognition and derecognition

15. The question the Committee considered asked only about the timing of recognition and derecognition following settlement. Therefore, we have not considered the requirements for the transfer or exchange of financial assets and financial liabilities.

16. For the recognition of financial assets and financial liabilities, paragraph 3.1.1 requires a financial instrument to be recognised when the entity becomes a party to the contractual

provisions of the instrument. Paragraph B3.1.2 provides examples of how this principle is applied, including:

(a) unconditional receivables and payable, which are recognised when an entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash; and

(b) assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services, which are generally not recognised until at least one of the parties has performed under the contract.

17. IFRS 9 specifies separate requirements for when a financial asset and financial liability is derecognised.

18. With regards to financial liabilities, paragraph 3.3.1 of IFRS 9 states that a financial liability is derecognised (ie removed from the statement of financial position) only when it is extinguished—ie discharged, cancelled or expires. Paragraph B3.3.1 of IFRS 9 further states:

> A financial liability (or part of it) is extinguished when the debtor either:
>
> (a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or
>
> (b) is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. …

19. With regards to financial assets, paragraph 3.2.3 of IFRS 9 sets out the general principle for derecognition of financial assets (for example, cash or trade receivables), stating:

> 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
>
> [...

20. With the exception of regular way purchases or sales of financial assets, IFRS 9 generally requires financial assets and financial liabilities to be recognised and derecognised on the settlement date, which is described in paragraph B3.1.6 as the date that an asset is delivered to or by an entity. In other words, settlement date accounting refers to (a) the recognition of an assets on the day the entity receives it; and (b) the derecognition of an asset (and recognition of any related gain or loss on disposal) on the day the entity delivers it.

Objectives of narrow-scope standard-setting

21. Consistent with paragraph 51 of Agenda paper 12A for the September 2022 meeting, in our view, the aim of any narrow-scope standard-setting must be 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.

22. Consistent with the staff view in paragraph 52 of Agenda paper 12A for the September 2022 meeting and our assessment against the PIR criteria in paragraphs 9-13 of this paper, in our view there is no evidence to suggest that a fundamental change to the derecognition requirements in IFRS 9 is justified or needed. Such an approach would be inconsistent with the overall feedback on the PIR that the derecognition requirements in IFRS 9 work as intended.

23. Furthermore, as noted in Agenda paper 3 for the September 2022 meeting, members of the Accounting Standards Advisory Forum (ASAF) confirmed at the July 2022 ASAF meeting that, although questions arise in practice about the application of the derecognition requirements, these questions are not pervasive and therefore not a priority for the IASB to consider.

24. We therefore think there are two potential narrow-scope standard-setting avenues to explore:

    (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.

Staff analysis on possible narrow scope of standard-setting

Clarification of particular aspects of the derecognition requirements of IFRS 9

25. The objective of such a potential clarification to IFRS 9 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).

26. The recognition and derecognition requirements in IFRS 9 are generally symmetrical—in other words, if one entity has a financial asset, another entity will have a financial liability (or equity instrument). However, there is not necessarily symmetry in the timing of recognition and

derecognition. An entity assesses its rights to receive cash and obligation to pay cash from its own perspective, based on the information it has at the reporting date; it does not base its accounting on what the counterparty has done.

27. As stated in paragraph B3.3.1 of IFRS 9, unless an entity is legally released from primary responsibility for a financial liability, the entity's contractual obligation to pay cash would expire (or be discharged) only through payment ie the delivery of cash or another financial asset on the settlement date as described in paragraph 20 of this paper. Similarly, the counterparty's contractual rights to receive cash expire only upon delivery of the cash or other financial asset.

28. Respondents to the Committee's tentative agenda decision said determining the exact timing of extinguishment of the liability and of expiry of the rights to cash flows could be time-consuming, costly and may involve significant (legal) analysis. They also said the legal analysis could identify a difference in timing between when a trade payable is extinguished and when the cash transferred as settlement for that trade payable is no longer available to the entity.

29. In our 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.

30. If the IASB were to pursue this option further, the scope of the project could potentially be wide and involve major standard-setting. This is because:

(a) IFRS 9 has separate derecognition requirements for financial assets and financial liabilities. Any potential clarification of the derecognition requirements for financial liabilities would need to be considered separately for financial assets; and

(b) the definitions of financial assets and financial liabilities refer to contractual rights and obligations to receive or deliver cash or another financial asset. Therefore, any potential clarification could not be limited to only electronic cash transfers or even cash more broadly; we would need to also consider other settlement transactions and delivery of other financial assets.

31. In our view, this means that 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.

32. As noted in paragraph 10 of this paper, evidence received on the PIR confirmed that there are no fundamental questions about the clarity and suitability of those derecognition requirements. Furthermore, respondents to the Committee's tentative agenda decision did not disagree with the Committee's technical analysis. Therefore, the staff is concerned that any clarification of the requirements that would apply broadly to all financial assets and financial liabilities would create a significant risk of unintended consequences. Because of this, any such change would need to be carefully considered by working through all the applicable scenarios. We anticipate such a project taking a considerable amount of time to complete.

33. As a result, if the IASB were to consider such a clarification of the general derecognition requirements in IFRS 9, it would require assessment against the IASB's other priorities in the workplan.

Accounting policy choice when specified criteria are met

34. The objective of this approach would be to explore whether derecognition could be permitted before the settlement date when specified criteria are met. This could take the form of an accounting policy choice (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.

35. As stated in paragraph 28 and confirmed by respondents to the tentative agenda decision, while there is symmetry in the derecognition requirements for a trade payable and the corresponding trade receivable, there could potentially be a difference in timing between losing control of the cash used for payment through electronic transfer and derecognising the related trade payable applying the requirements in IFRS 9.

36. This is because, in some electronic payment systems, once an entity has initiated a payment, the cash is no longer available for use by the entity even though it might still be in the entity's account. In other words, the entity has effectively lost control of the cash. However, if the cash has not yet been delivered to the counterparty as settlement for the payable, the financial liability may not be extinguished.

37. There is a significant number of payment mechanisms used world-wide for the payment of cash, each with its own features and processing time. The process may also be different for

other settlement transactions (for example, when delivering financial assets other than cash). It would therefore not be possible to consider and address each payment system when developing a potential standard-setting solution.

38. However, we think it might be 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.

39. Although the notion of control is not prevalent in accounting for financial instruments (which is based on the contractual rights and obligations of the instrument), assessing control is one of the steps in determining whether the transfer or sale of a financial asset qualifies for derecognition. For the purpose of exploring potential narrow-scope standard-setting, we therefore think it might be helpful to consider whether an entity has lost control of cash when initiating an electronic payment. In our view, relevant questions to consider include:

   (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 (ie 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.

40. 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). In other words, the entity has effectively lost control of the cash. The entity might also be reasonably certain at that point that the cash will be delivered to the counterparty in accordance with the standard processing time for the specific electronic payment system, which is usually within a short timeframe

41. 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.

42. We note that the most significant concerns stakeholders raised in response to the Committee’s tentative agenda decision related to the derecognition of financial liabilities (ie trade payables) rather than financial assets. We also note that an ever-increasing number of payment transactions are made electronically. We therefore think that this approach would be responsive to many of the concerns raised. We acknowledge however that such a narrow-scope amendment to IFRS 9 would not resolve all of the concerns raised. However, it would retain the derecognition requirements in IFRS 9 without requiring any fundamental change, while providing practical relief by permitting current accounting practices to continue in specified circumstances. An analogy to other settlement transactions would not be possible, thereby reducing the risk of unintended consequences.

Staff preliminary views

43. Evaluating the presented options for a narrow-scope amendment to IFRS 9 in response to stakeholders’ concerns raised, the staff are of the view that:

(a) clarifying the general derecognition requirements in IFRS 9 could have unintended consequences. It could potentially result in requiring a fundamental change to the existing requirements that would affect transactions beyond which concerns were raised; and

(b) considering such an amendment would go beyond being a narrow-scope project. It would require quite some consultation, time and resources and, therefore, could not be completed in a timely manner.

44. With respect to a narrow-scope amendment that would permit the derecognition of a financial liability before the settlement date when using an electronic cash transfer, in our view such an 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.

45. On balance in our view the introduction of an accounting policy choice for financial liabilities is the preferred option to pursue to ensure a timely and effective response to the concerns raised while avoiding unintended consequences.

Question for the IASB

Question for the IASB
Do you agree with the staff proposal to explore permitting the derecognition of financial liabilities before settlement date if specified criteria are met? Do you have any other comments or suggestions to help direct the staff's further work?