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Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Ms Lloyd

Tentative agenda decision – Cash Received via Electronic Transfer as Settlement of a Financial Asset (IFRS 9)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the September 2021 IFRIC Update of the tentative agenda decision (TAD) not to take onto the Committee's agenda the request for clarification on the timing of recognition of cash received via an electronic transfer system as settlement for a financial asset.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda. However, as explained below, we believe the analysis presented in the TAD:

- has applicability to other related transactions not analysed by the Committee (e.g. cash settlement of trade payables and banking cash transactions)
- presents significant practical, operational and legal challenges for preparers for the transaction presented in the TAD and other related transactions
- could result in significant costs to implement (e.g. costs for legal analyses to be performed for multiple jurisdictions and payment systems)
- has the potential for unintended consequences or to increase diversity in practice for other related transactions.

Consequently, we believe that this issue should be referred to the Board to consider the wider consequences of the analysis in the TAD and to perform a comprehensive cost/benefit analysis before concluding on the matter. Given that the Board is considering certain derecognition issues as part of the post-implementation review (PIR) of IFRS 9, it may be appropriate to consider this issue, at the heart of which is the timing of recognition and derecognition of financial assets (and financial liabilities), as part of that PIR.

The issues identified above are explained in more detail below.

Applicability to other related transactions

The analysis in the TAD considers only the specific transaction submitted to the Committee, which is the receipt of cash via electronic transfer to settle a trade receivable. In the context of this transaction, the Committee's conclusion is that, applying IFRS 9, the trade receivable is derecognised only once the contractual rights to cash flows from the trade receivable have expired.

However, key reasons why diversity arises in practice when accounting for this seemingly basic transaction include the practicalities of application of the derecognition requirements and the need for consistency with the treatment of related transactions, namely the accounting for the payments made to settle trade payables and other liabilities.

Although not explicitly addressed in the TAD, it seems that the conclusion that the trade receivable should not be derecognised until the contractual rights to cash flows from the trade receivable have expired could also apply to the counterparty's trade payable as noted in the IFRIC Staff's Agenda Paper[1]. Consequently, if the TAD is finalised, the analysis presented in the TAD may need to be applied to the settlement of trade payables as well as trade receivables. In our experience, it is common practice for the payer to derecognise cash at the point when the electronic payment to settle a trade payable is instigated. This reflects the fact that at that point the cash is no longer available to the payer for any other purpose, i.e. the cash in transit to settle the trade payable is not available 'on demand' as the payment process is designed to ensure financial intermediaries complete the payment as instructed. Accordingly, if a more exhaustive analysis is not provided, in particular to address the accounting for the settlement of trade payables, there is a risk that the TAD could increase diversity in practice. For example, diversity in the accounting for trade payables may increase if some, but not all entities, align their accounting for the settlement of trade payables to the analysis presented in the TAD for trade receivables. There is also the risk that entities could apply inconsistent derecognition principles to trade receivables versus trade payables.

Presentation of cash by the payer

From the payer's perspective, if a trade payable is not extinguished at the point of instigating an electronic cash transfer (and therefore not derecognised), a question arises as to the impact of the initiation of the cash transfer on the entity's reported cash balance. Cash is defined in IAS 7 as 'cash on hand and demand deposits'. In some cases, the instigated payment may be cancellable and immediately demandable without cost and therefore the cash in transit may continue to meet the definition of cash. However, in other cases, once payment is instigated, the cash is no longer available on demand. This will be the case when the cancellation of the instigated payment is subject to further procedures, including cancellation fees, before the cash in transit is returned. This will also be the case when an instigated payment cannot be cancelled, and cash is returned to the payer only if there is a failure in the settlement process. This raises the question of how cash in transit that is no longer available 'on demand' should be presented if the related trade payable is not yet considered settled. Preparers will face this issue, not currently addressed in the TAD, if the TAD is finalised as currently drafted.

The analysis required to determine when the instigation of a cash transfer results in derecognition of cash is complex because of the multiple settlement mechanisms that exist, each with different rules on the ability to cancel initiated transfers, the incurrence of cancellation fees, the exact time of expiry of that cancellation window and the time taken for procedures to be completed for the return of cash from cancelled transfers. It is unlikely that these analyses have been typically conducted until now given that entities do not routinely cancel electronic payments unless the payment is instigated in error (which will be limited if effective controls are in place).

[1] Paragraphs 32-35 of Agenda Paper 6 from the September 2021 IFRIC meeting

Timing of legal extinguishment

A similar question arises in respect of the timing of the legal extinguishment of the trade receivable (and the corresponding trade payable). If legal extinguishment occurs when the paying bank has transferred cash to the receiving bank rather than when the cash is available in the receiving entity's bank account (which may be later in the settlement cycle), the timing of extinguishment may not be known without additional information and analysis (e.g. for international transfers legal extinguishment may arise sometime in the middle of the settlement cycle, rather than only at the end). To answer this question, it will be necessary to understand the legal rights of the parties if the receiver's bank failed after the cash was received by the bank but before the receiver's bank account was credited with the funds. Would the receiver have a claim on the payer, or would the payer's obligation be extinguished at this point and the receiver's claim be solely on its own bank?

Similarly, from the payer's perspective, although the entity may no longer have access to the cash on demand from its bank, it may not know the precise time its bank has transferred the funds to the receiver's bank or when the cash is credited in the receiver's bank account. This adds further uncertainty regarding the timing of extinguishment.

Obtaining legal advice to establish when trade receivables (and trade payables) are extinguished for the different jurisdictions and settlement systems involved will be time consuming and costly for entities, particularly large international groups.

Other transactions

In addition to affecting the accounting treatment for the settlement of trade receivables and trade payables via electronic cash transfers, the analysis in the TAD may also be relevant for other settlement transactions. We would encourage the Committee (and the Board) to consider the impact, if any, on these other transactions before concluding on the matter. For example, current practices in respect to the timing of extinguishment and derecognition of the following transactions may also be affected by the analysis in the TAD:

- settlement of trade payables and trade receivables via the issue and banking of cheques
- cash settlement of banking transactions (e.g. timing of extinguishment of loans receivable and loans payable settled in cash using electronic transfers or cheques)
- settlement of trade payables and trade receivables via overdrafts (i.e. payment to settle a liability resulting in an increase in an overdraft position or receipt of cash to reduce an overdraft position resulting in a need to consider not only recognition/derecognition of cash but also recognition/derecognition of financial liabilities (e.g. overdrafts)).

Cost/benefit analysis

Based on our experience, although there is diversity in practice for the treatment of cash settlements, we believe that there are two prevalent practices. Cash is either recognised/derecognised at the point of instigation of the transfer or at the point of settlement of the transfer, with the corresponding trade receivable/payable derecognised at the same time.

If the TAD is finalised as currently proposed, we are concerned that, due to some of the complexities highlighted above, entities may still reach different conclusions on the point of legal extinguishment. This could mean that despite the significant costs incurred by preparers to align their accounting policies to the conclusions reached by the Committee, inconsistent accounting for the same transactions will remain.

Furthermore, the accounting treatment applied for cash transactions often follows long established processes and procedures that are embedded in an entity's systems and controls. The effect of adopting the analysis in the TAD is expected to require significant changes to these processes and procedures which in some cases will be time consuming and costly to implement.

Given the significant practical, operational, legal and cost challenges identified above, the benefit of derecognising the trade receivable/payable at the exact point of legal extinguishment needs to be weighed up against the costs of achieving this accuracy (especially when the policy adopted is clearly disclosed). Consequently, we believe this issue should be referred to the Board to perform a comprehensive cost/benefit analysis and consider clarifying the meaning of extinguishment in IFRS 9 in respect of financial assets and financial liabilities settled through established settlement systems as part of the PIR on IFRS 9 currently underway.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

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Global IFRS Leader