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Amendments to Classification and Measurement of Financial Instruments – Accounting policy choice for derecognition of financial liabilities Issues Paper

Objective

- 1 To seek views of EFRAG FR TEG on the IASB staff amended proposals and the IASB decision for accounting policy choice for derecognition of financial liabilities.

The amendments to the initial proposals

- 2 In drafting the proposals the IASB staff took into account comments and questions of the IASB members at the IASB October meeting.
- 3 In the agenda paper 16B, the IASB staff goes deeper into the underlying rationale of the proposals, provides additional reasoning and explanations. The amendments and refinements to the initial proposals are presented below.

Criteria

Irrevocably committed

- 4 To reply to some IASB members concerns, the IASB staff proposes to replace **‘irrevocably committed to making a payment’** by further refining this criterion to require an entity **‘to not have the ability to withdraw, stop or cancel a payment instruction’**.
- 5 This is to better define the moment when the entity is irrevocably committed to settle the liability on the payment initiation date.

Loss of control

- 6 The IASB staff explained that when referring to an entity effectively having lost control over the cash, the staff had in mind situations where an entity has lost the practical ability to access that amount of cash even though the cash has not left the entity’s account yet. For example, the cash might still be included in the entity’s cash balance with the bank, but the available balance has been reduced by the amount of the payment transaction, and the transaction is shown as ‘pending’ or ‘on hold’.
- 7 Nevertheless, recognising that that control per se is not generally used when determining whether a financial instrument is recognised or derecognised and the potential risk for unintended consequences this could bring, the IASB staff recommends referring to **‘an entity no longer having the practical ability to access the cash’** rather than **‘no longer having control of the cash’**.

Settlement risk

- 8 The IASB staff also clarified that the settlement risk refers to the risk that the asset will be not delivered by the debtor on the settlement date. For any potential accounting alternative to derecognise a financial liability before the settlement date, the **risk of the settlement** not occurring must be **insignificant**.
- 9 The IASB staff referred to the paragraphs AG38F and 42(b) of IAS 32 for a gross settlement system meeting net settlement criterion if it eliminates or result in insignificant credit and liquidity risk. The IASB staff notes that for both regular way transactions in IFRS 9 and particular gross settlement systems in IAS 32, one of the key principles is that the risk of settlement not occurring is insignificant.
- 10 Therefore, it redefined the original criterion of ‘completion of the cash transfer is subject only to an administrative process and not settlement risk of the entity’ by defining the characteristics of the payment method used for settling the obligation with an insignificant settlement risk:
 - (a) the period between the payment initiation date and settlement date is relatively short and is standardised for the particular payment method concerned. The longer the standard processing time for a particular payment method the higher the risk that the payment may not be completed due to default of the debtor; and
 - (b) completion of the payment instruction follows a standard administrative process so that the debtor has reasonable assurance that the transfer will be completed and the cash will be delivered to the creditor.

Scope

- 11 The IASB staff considered whether to enlarge the scope of the accounting policy choice to all the cash disbursements and / or to financial assets side.

All cash disbursements out of demand deposits

- 12 In the IASB staff view scoping in all the payment methods would create several practical and conceptual challenges, such as considering other types of accounts then demand deposits or treating cash differently from other financial assets.
- 13 In the IASB staff view such an approach will not result in a narrow-scope amendment, but require a fundamental change to the derecognition requirements in IFRS 9 which in turn will require more time and resources to complete, thus causing a significant delay of the project.

Settlement of financial assets

- 14 In addressing the comments that initial IFRS IC submission related to accounts receivable, the IASB staff notes that most of the comments made in the context of receivables were related to the classification of receivables as ‘cash in-transit’ or cash equivalents. These questions are outside the scope of IFRS 9 and therefore not relevant to the proposed accounting alternative. The arguments in paragraph 13 are also valid if the assets side is included.

Conclusion

- 15 Taking into account the arguments discussed above the IASB staff proposes **limiting the narrow-scope amendment only to electronic cash transfers using an electronic payment system**.
- 16 In their view such a solution will be operable, mitigate risk of unintended consequences, will not significantly reduced the usefulness of the information provided and will allow the affected entities to continue the current practice.

Final proposals and the IASB decision

- 17 The IASB staff recommends clarifying that an entity applies settlement date accounting when recognising and derecognising financial assets (except for regular way transactions) and financial liabilities.
- 18 With regards to the accounting alternative for derecognising a financial liability before settlement date, the IASB staff recommends refining the criteria to require:
- (a) an entity to have no ability to withdraw, stop or cancel an electronic payment instruction;
 - (b) the entity to have lost the practical ability to access the cash as a result of the electronic payment instruction; and
 - (c) the settlement risk associated with the electronic payment instruction to be insignificant. For this to be the case, the payment system used must have the following characteristics:
 - (i) the period between the payment initiation date¹ and settlement date² is relatively short and is standardised for the particular payment system concerned; and
 - (ii) completion of the payment instruction follows a standard administrative process so that the debtor has reasonable assurance that the transfer will be completed, and the cash will be delivered to the creditor.
- 19 At its November meeting all the 11 IASB members agreed with the IASB staff proposals. It was clarified during the meeting that all the proposed amendments will have the same transition requirements (modified retrospective approach) and a question in this regard could be added to the exposure draft.

EFRAG working groups

- 20 EFRAG FIWG discussed this topic at its 22 November 2022 meeting and on overall welcomed the proposed clarifications and supported the narrow scope solution.
- 21 However, some members were concerned about excluding payments made from overdraft facilities. In these members' view overdrafts were part of a cash balance of an entity and as long as they are provided within the same facility limit, payments from overdraft accounts should be included in the scope to avoid the differing accounting treatments based on the type of account used.
- 22 One EFRAG FIWG member noted that outcome of this tentative agenda decision ('TAD') will make a precedent in IFRS application: if the proposed accounting policy choice for the electronic cash transfers will be the only amendment which will result from the TAD, the question about the consequences for the transactions outside of

¹ The IASB staff provides the following explanation for the payment initiation date: "Typically, entities facilitate most cash payments to settle its financial liabilities by issuing payment instructions to an entity's bank. The bank then processes these payments as instructed by entity, subject to there being sufficient available funds in the entity's account to cover the payment. Payment instructions can be made in various forms, for example using electronic transfer systems such as Bacs or CHAPS, cheques or online payments. We will call this 'the payment initiation date' of the payment for the purpose of this paper."

Although an entity might be committed to settle the liability on the payment initiation date, depending on the payment method used, the entity might still be able to withdraw, stop or cancel the payment instruction and therefore the entity is not irrevocably committed to the payment."

² IFRS 9 B3.1.6: The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity.

the scope remains open. The Basis for Conclusions will become very important in this case.

- 23 EFRAG IAWG discussed this topic at its 24 November 2022 meeting. One member although agreeing with IFRS IC TAD on technical and conceptual grounds, welcomed the proposed amendments from a preparer perspective and appreciated their urgency. This member, however, questioned the scope limitation to the electronic payments only and suggested that the scope of the amendments could be revised in the future.

The EFRAG Secretariat analysis

- 24 The EFRAG Secretariat welcomes the amendments proposed for criteria for the for derecognising a financial liability before settlement date. In our view, these amendments provide more clarity and avoid ambiguity in interpretations of 'irrevocably committed', 'effectively lost control', no settlement risk, etc. However, we suggest to define the 'payment initiation date'.
- 25 The EFRAG Secretariat agrees that limiting the scope of the proposed accounting policy choice only to electronic cash transfers using an electronic payment system will provide a workable and timely solution for the transactions in question, however the uncertainty remains on how the other payment transactions (cheques and credit cards) should be treated and whether the TAD provisions will be applicable to them.

Questions for EFRAG FR TEG

- 26 Does EFRAG FR TEG agree with the IASB staff recommendation to limit the scope of the proposed amendments to electronic cash transfers using an electronic payment system?
- 27 Does EFRAG FR TEG agree with the proposed criteria for derecognising a financial liability before settlement date?
- 28 Does EFRAG FR TEG agree with the using of terms 'payment initiation date' and 'settlement date' in paragraph 18(c)(i) of this paper?
- 29 Does EFRAG FR TEG have any other comments on the IASB staff proposals?