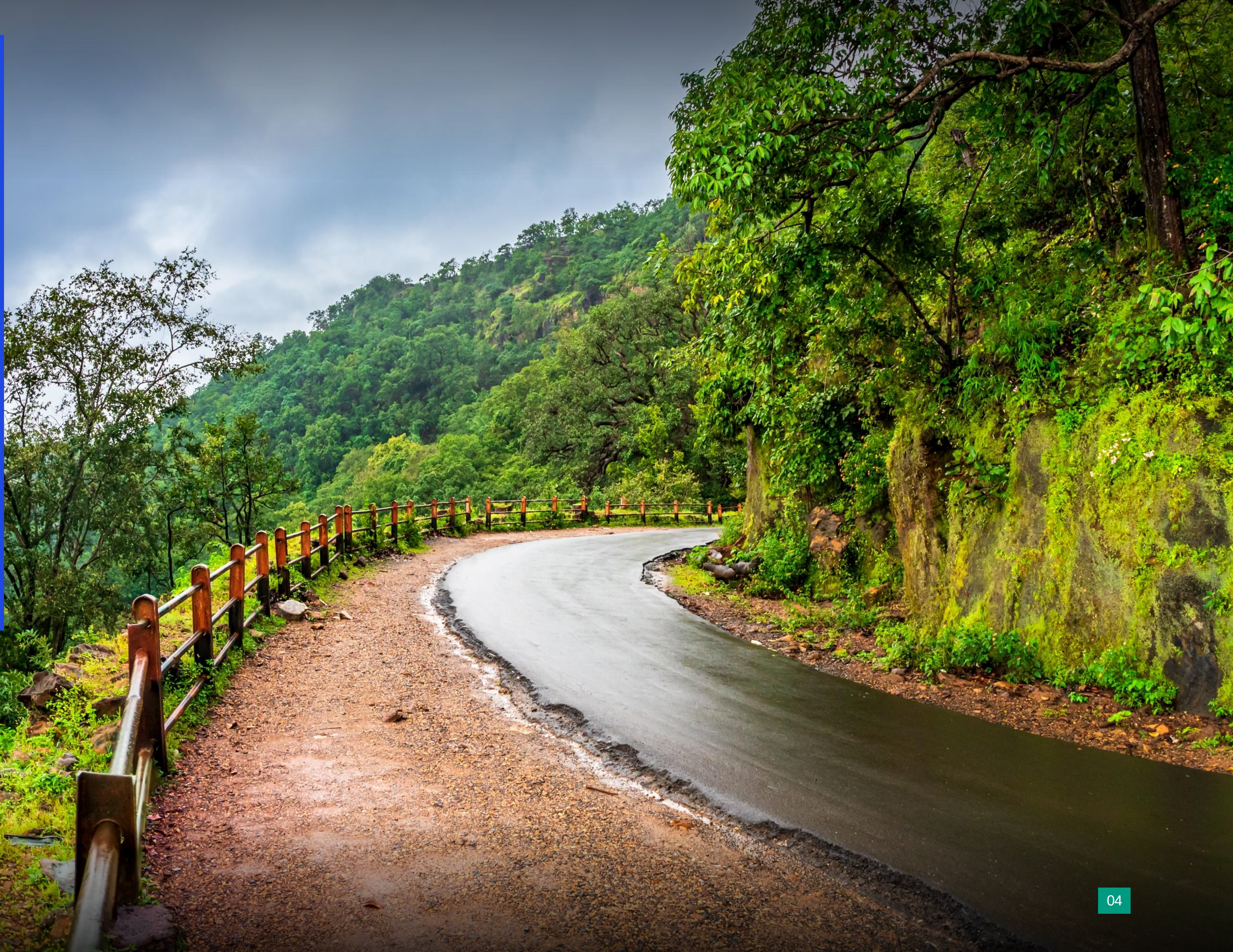
CHAPTER 1

Settlement by electronic payments

This article aims to:

Explain the new guidance with regard to recognition and derecognition for both financial asset (receivable) and financial liability (payable).



Introduction

The International Accounting Standards Board (IASB) amended financial instrument standards for derecognition of financial instruments.

These amendments are to be applied retrospectively without impacting comparative financial information.

Background

IFRS Interpretation Committee issued a tentative agenda decision on 'Cash Received via Electronic Transfer as Settlement for a Financial Asset' in September 2021. The committee concluded the following:

- An entity to derecognise a financial asset when, and only when, 'the contractual rights to the cash flows from the financial asset expire'.
- Determining the date on which the entity's contractual rights to those cash flows expire is a legal matter,
- The entity to recognise cash as a financial asset on the transfer settlement date, and not before
- 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 received as settlement for the trade receivable (for example, a right to receive cash from the customer's bank)[1].

The question of when to recognise or derecognise a trade receivable or payable seems relatively simple on the surface. However, it has generated a significant amount of debate because there is diversity in practice for both the receivable and payable sides of the transaction[2].

In September 2022, the IASB decided to explore narrow-scope standard-setting as part of its post-implementation review of IFRS 9, Financial Instruments.

1. IFRIC Update September 2021, Cash Received via Electronic Transfer as Settlement for a Financial Asset (IFRS 9 Financial Instruments)—Agenda Paper 6
2. KPMG IFRG Limited' publication, Settlement by electronic payments, May 2024

IFRS 9 updates on recognition and derecognition criteria

Through IFRS 9 updates, the IASB has re-emphasised the principle of derecognition of financial assets to be ‘the date on which the contractual rights to the cash flows expire or the asset is transferred’[3] and clarified the principle of derecognition of financial liabilities to be on the settlement date[4].

The IASB has now brought in exception to derecognition of financial liabilities settled by electronic payments through its application guidance i.e. entities may be permitted to derecognise financial liabilities settled by an electronic payment system earlier than their settlement date, subject to certain criteria being met.

Following example[5] explains the point of time at which an entity can derecognise financial liability being settled through electronic payment system:

T0 – Payment of 2,000 initiated

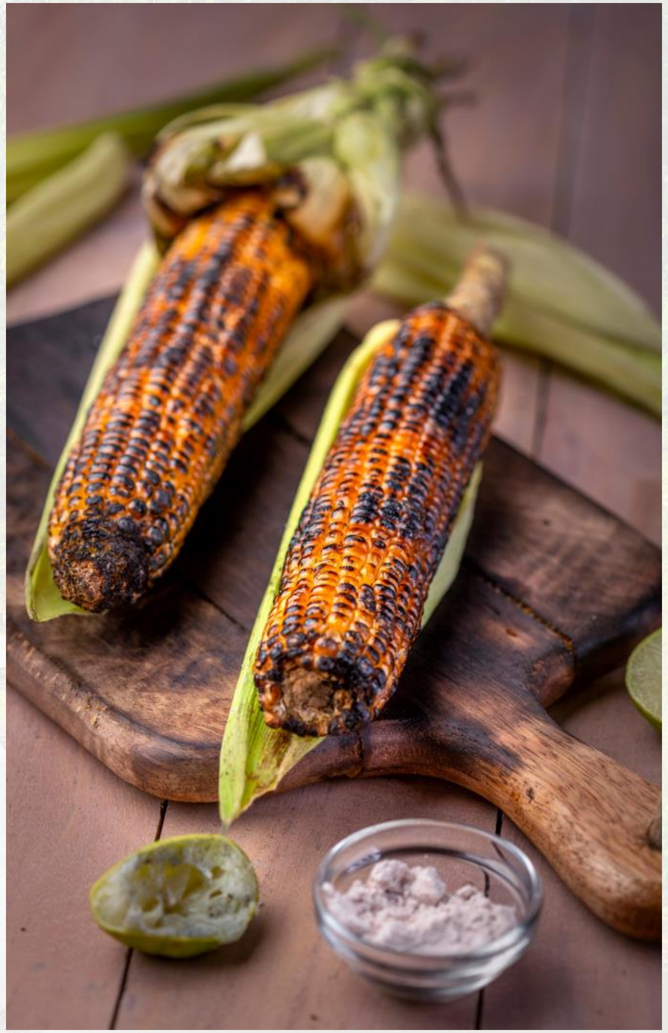
T1 – Payment cannot be cancelled

T2

T3 – Payment completed

New derecognition exception criteria

1. No practical ability to cancel the payment
2. No practical ability to access the ₹2,000
3. Settlement risk associated with this payment system is insignificant



3. Technical reference from existing IFRS 9 - paragraph 3.2.3 of IFRS 9
4. Technical reference from existing IFRS 9 - paragraph 3.3.1 of IFRS 9
5. KPMG IFRG Limited’ publication, Settlement by electronic payments, May 2024

Practical issues

Companies can choose to apply the exception for electronic payments on a system-by-system basis. In the Indian context, the Reserve Bank of India (RBI) has equipped various payment systems such as NEFT, RTGS, IMPS, cards network, etc. Given the widespread use of electronic payment systems, determining whether the exception criteria would be met for each one may require significant time and effort.

Companies will have to assess the impacts on their financial statements:

- Companies that recognise or derecognise financial assets or financial liabilities on the payment initiation date could see a change to their accounting following the clarification in amendments to IFRS 9;
- Companies applying the new requirements for financial liabilities settled through electronic payments would impact financial reporting processes, such as bank reconciliations; and
- The amendment will result in incremental work to review the terms and conditions of electronic payment systems to assess whether the specific criteria for the exception will be met.

Applicability and next steps

The amendments apply for reporting periods beginning on or after 1 January 2026. Companies can choose to early-adopt the amendments for the recognition and derecognition of financial assets and financial liabilities, separately from the amendments on classification and disclosures.

These amendments are to be applied retrospectively but it should not impact comparative financial information and impact of cumulative effect to be given on the opening balance of financial assets and financial liabilities and the opening balance of retained earnings, if any.