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Supplier Finance Arrangements Update

Objective

- 1 The objective of this agenda paper is to provide EFRAG TEG members an update on the IASB's project *Supplier Finance Arrangements*

IASB's discussions and tentative decisions

- 2 In June 2021 the IASB discussed what it had heard from investors and analysts, the Committee and other stakeholders about investor information needs related to supplier finance arrangements (such as reverse factoring and similar arrangements) and tentatively decided (after taking into account the [IFRS Interpretations Committee agenda decision](#)):
 - (a) to add a narrow-scope standard-setting project to its work plan to meet these investor information needs.
 - (b) that the project would develop disclosure requirements for supplier finance arrangements, but not go beyond such arrangements (that is, the project would not develop requirements for arrangements an entity enters into to fund either receivables from customers or inventories).
 - (c) to explain the type of arrangements to be included within the project's scope, instead of proposing detailed definitions.
 - (d) to propose amending IAS 7 *Statement of Cash Flow* to add:
 - (i) an overall disclosure objective: to help users of financial statements understand the nature, timing, and uncertainty of cash flows arising from supplier finance arrangements; and
 - (ii) specific disclosure objectives:
 - to provide quantitative information that helps users of financial statements determine the effects of supplier finance arrangements on an entity's financial position and cash flows; and
 - to provide qualitative information to help users of financial statements understand the risks that arise from supplier finance arrangements.
 - (e) to propose that, to meet the proposed disclosure objectives, entities be required to disclose:
 - (i) the key terms and conditions of a supplier finance arrangement; and

- (ii) at the start and end of the reporting period:
 - the aggregate amount of payables that are part of the arrangement;
 - the aggregate amount of the payables disclosed for which suppliers have already received payment from the finance provider;
 - the range of payment terms, expressed in time, of payables disclosed; and
 - the range of payment terms, expressed in time, of trade payables that do not form part of the arrangement.
 - (f) to propose adding supplier finance arrangements as an example within the liquidity risk disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*.
- 3 Nonetheless, a few IASB Board members highlighted that the IFRIC agenda decision stated that the principles and requirements in IFRS Standards already provided an adequate basis for an entity to account for supply chain arrangements and that the IASB should not address every issue that arises in practice, including compliance issues.
- 4 In July 2020 the IASB discussed the requirements for the transition to, and early application of, the proposed amendments to IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures*. The IASB also discussed due process, including permission to begin the balloting process.
- 5 The IASB tentatively decided to:
- (a) require entities to apply the proposed amendments retrospectively in accordance with IAS 8;
 - (b) provide no exemption for first-time adopters;
 - (c) permit an entity to apply the proposed amendments earlier than the effective date;
 - (d) allow a comment period of no fewer than 120 days for the exposure draft of its proposed amendments to IAS 7 and IFRS 7.
- 6 All IASB members confirmed they were satisfied the IASB Board has complied with the applicable due process requirements and has undertaken sufficient consultation and analysis to begin the process for balloting the exposure draft.
- 7 No IASB member indicated an intention to dissent from the proposals in the exposure draft.

EFRAG Secretariat analysis

- 8 The EFRAG Secretariat welcomes the IFRS Interpretations Committee ('the committee') agenda decision. The EFRAG Secretariat also supports a disclosure project to develop clear and specific disclosure requirements that focus the attention of preparers and auditors, provide additional information to users and facilitate enforcement.
- 9 These initiatives are a step forward in addressing the issues highlighted by EFRAG in its comment letter to the IASB on Primary Financial Statements. The Committee agenda decision and the IASB's project on disclosures are likely to improve significantly the reporting of financial information about supply chain financing arrangements in the future.

- 10 However, the EFRAG Secretariat considers that the IASB should take the opportunity to:
- (a) consider whether further clarifications or improvements could be done within the project *Primary Financial Statements* project. In particular, improvements that could help users easily assess the true level of borrowing from financial creditors (including net debt). Please see paragraph 11 below. Therefore, the EFRAG Secretariat highlights the linkage between these two projects.
 - (b) consider further improvements to the disclosures. Please see paragraph 12.
- 11 More specifically, the EFRAG Secretariat would welcome guidance on
- (a) **Presentation in the statement of financial position:**
 - (i) the EFRAG Secretariat considers that it is important to provide guidance not only on separate presentation but also proper labelling on the face of the financial statements (e.g. use of ‘trade payables’, ‘other creditors’, ‘borrowings’, ‘short term debt’ or ‘financial debt’) - please also see suggestion in paragraph 11(d) below. We recall that an UK construction business in 2018 that received a lot of attention in the UK presented these liabilities separately as ‘other creditors’ (i.e. separately from trade payables), which was much criticized as it was not presented as not part of financial debt, and consequently not reflecting such amounts in debt to earnings ratio, covenants and cash conversion ratios. This seems to be recognised by the IFRS Interpretations Committee when discussing the statement of cash flows, which refers to ‘borrowings of the entity’, but not when discussing the statement of financial position. Users have also raised the issue of splitting the amount as classifying the entire payable as a loan payable would overstate the entity’s borrowings
 - (ii) It would also be important to have additional details on the consequences of their classification in the different primary financial statements, when considered altogether (statement of financial position, financial performance and cash flows), particularly in light of any decisions on the IASB’s project Primary Financial Statements.
 - (iii) The EFRAG Secretariat is concerned that in the absence of standard-setting activity by the IASB to address the specificities of reverse factoring arrangements in terms of classification and labelling on the face of the financial statements, diversity in practice may still persist especially for the degree of judgement involved in the approach to the classification and presentation of the liabilities related to these transactions in the statement of financial performance and statement of cash flows.
 - (b) **Presentation in the statement of profit or loss:** there is the question of how the income and expenses that arise from reverse factoring should be presented in the statement of profit or loss (e.g. as part of finance costs), particularly when considering the IASB proposals in its project Primary Financial Statements. For example, in its Exposure Draft *General Presentation and Disclosures* the IASB concluded that any income and expenses from trade payables on extended credit terms should be presented in the financing category in the statement of financial performance. This raises the question of whether any income and expense from a reverse factoring arrangement where an entity obtains extended credit from the finance provider should also be considered as part of financing activities.

- 12 In terms of **disclosures**, the EFRAG Secretariat highlights the importance of:
- (a) Helping users finding the disclosures related to supply finance agreements. For example:
 - (i) by requiring the key disclosures on supplier finance arrangements to be located in a single place in the notes;
 - (ii) ensuring that entities use consistent terminology when describing their supplier finance arrangements accounting policy (e.g. reverse factoring, supply chain factoring, supply chain financing, early payment scheme, supplier payment scheme, etc);
 - (b) helping management to prepare the disclosures by providing a comprehensive package of disclosures that includes all disclosures required (including integrating those mentioned in the [IFRS Interpretations Committee agenda decision](#)). For example, requiring specifically, together with the key terms and conditions of a supplier finance arrangement, management’s decision and judgements on how to present liabilities and cash flows related to reverse factoring (i.e. why management considers that the recognised liability is akin to trade payable or to short term debt). Or including specific references related to supplier finance arrangements on when to present a financial liability separately.
 - (c) identifying where the amounts subject to supplier funding arrangements have been included in the primary financial statements (statement of financial position, financial performance and cashflows), taking into account the different types of arrangements;
 - (d) Providing indicators of when a liability represents borrowings of the entity, and consequently can no longer be classified as trade payables (e.g. an entity obtains extended credit from the finance provider, the financial institution legally novates the payable, the financial institution is not simply a paying agent, etc). That is, more guidance that would help management to make a distinction between the different type of arrangements.
 - (e) considering whether there is a need to separate disclosures, depending on the classification of the liability as trade payable or short term debt.
 - (f) If retrospective information is required, the IASB should consider a longer implementation period as some of the information may be difficult to obtain, particularly the aggregate amounts proposed above.

Questions for EFRAG TEG

- 13 Do EFRAG TEG members have any comments on the IASB’s tentative decisions related to supplier finance arrangements?
- 14 Do EFRAG TEG members agree with EFRAG Secretariat analysis?