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Supplier Finance Arrangements

Cover Note

Objective

- 1 The objective of the session is to discuss and agree to recommend to the EFRAG Board a draft comment letter on the exposure draft ED/2021/10 *Supplier Finance Arrangements* (the 'ED'), issued by the IASB on 26 November 2021.

Background of the IASB project

- 2 In early 2020, the IFRS Interpretations Committee (IFRS IC) received a request about reverse factoring arrangements, more specifically:
 - (a) how an entity presents liabilities to which reverse factoring arrangements relate (i.e. how it presents liabilities to pay for goods or services received when the related invoices are part of a reverse factoring arrangement); and
 - (b) what information about reverse factoring arrangements an entity is required to disclose in its financial statements.
- 3 In a reverse factoring arrangement, a financial institution agrees to pay amounts an entity owes to the entity's suppliers and the entity agrees to pay the financial institution at the same date as, or a date later than, suppliers are paid.
- 4 Following research and outreach activities, the IASB Staff identified that entities report reverse factoring arrangements in diverse ways, and the extent to which entities provide information about reverse factoring arrangements can vary. Particularly in the statement of financial position (i.e. presentation of trade payables or other financial liabilities) and statement of cash flows (i.e. presentation of operating cash flow or financing cash flow). Finally, the research showed that entities often do not disclose the existence of reverse factoring arrangements.
- 5 In December 2020, the IFRS IC published an [agenda decision](#) which concluded that current principles and requirements in IFRS Standards provide sufficient guidance for entities to apply to reverse factoring arrangements.
- 6 However, in June 2021, after discussing the feedback received from investors and analysts, the IASB tentatively decided to add a narrow-scope standard-setting project to address investor information needs related to supplier finance arrangements, in particular to:
 - (a) explain the type of arrangements within the scope, rather than include specific definitions;
 - (b) add qualitative and quantitative disclosure requirements to IAS 7;
 - (c) to highlight existing disclosure requirements in IFRS 7.

- 7 The IASB published an [exposure draft](#) on the project on 26 November 2021 with a comment period of 120 days. The publication has a comment deadline on 28 March 2022. The ED can be consulted in agenda paper 07-03.

Background of the EFRAG discussions

- 8 EFRAG TEG discussed the key messages that formed the basis of the EFRAG draft comment letter (DCL) on this project at its meeting in November 2021. EFRAG TEG members made the following suggestions on:
- (a) *project scope* – in general, members were supportive of a narrow scope project focused on disclosures and recommended that the EFRAG DCL stayed focused on the disclosures as they would deliver information useful to users of financial statements. It was important for the SFA project to be completed in a timely manner and the classification and presentation issues could be dealt with later in a separate and more comprehensive project. Thus, the letter should be constructive for the current project but anticipate what need to be done in the future;
 - (b) *linkage to other IASB projects* – members acknowledged that the SFA project was linked to issues discussed in other IASB projects: *Primary Financial Statements* project and *Disclosure Initiative-A Pilot Approach*. They suggested that the EFRAG DCL should remind of this linkage, however, it should not suggest that those issues should be resolved in the SFA project;
 - (c) *statement of financial position* – members commented that separate presentation of liabilities under SFA should not be required as IAS 1 *Presentation of Financial Statements* already provided guidance on this aspect. Furthermore, members commented that developing a clear dividing line (bright line) between trade payables and financial debt related to SFA would be difficult to achieve. However, they supported having indicators that would help entities determine the classification of liabilities under such arrangements;
 - (d) *statement of cash flows* – members suggested to highlight in the EFRAG DCL what type of disclosures would be needed for the statement of cash flows;
 - (e) *additional disclosures* – members disagreed to require additional disclosures about the impact of SFA on leverage, liquidity and working capital cycle because these were related to how SFA affected management performance measures.

Feedback from EFRAG User Panel

- 9 On 7 December 2021, EFRAG User Panel considered the proposals included in the IASB's ED on supplier finance arrangements and the key messages for the EFRAG DCL revised with the comments made by EFRAG TEG during its November discussion:
- (a) *IASB's project on disclosures related to supplier finance arrangements*: EFRAG User Panel members were broadly supportive of the direction of the project to require entities to provide specific disclosures related to supplier finance arrangements. Members further made the following comments on:
 - (b) *project scope* – members expressed support for the IASB's approach to describe rather than define what supplier finance arrangements were. They considered the approach to be practical and less prone to structuring opportunities. However, it was noted that it might capture wider range of arrangements than anticipated. Furthermore, members commented that focusing the scope on supplier finance arrangements that lengthen the payment period would simplify the project;

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- (c) *proposed disclosures* – members expressed general supports for the proposed disclosure requirements under the ED and commented on:
- (i) *presentation of supplier finance arrangements* - members considered that further improvements were necessary with respect to presentation, classification and measurement of liabilities under such arrangements. In particular:
 - some members supported the IASB approach to start first by requiring disclosures about supplier finance arrangements and later consider improvements to the presentation and classification of these arrangements in other related projects in the future. This will result in a timely completion of the project and provide users with information about such arrangements;
 - other members considered that the presentation of cash flows under supplier finance arrangements was important and warranted consideration by the IASB at this stage of the project;
 - (ii) *comparability* - members commented that they wanted to be able to understand how account payables would look like if supplier finance arrangements were not used;
 - (iii) *range of payment due dates* - users considered that contractual payment terms between the entity and the finance provider should be the starting point for disclosures related to due payment dates. This will provide users with information about when it has to pay the finance provider;
- (d) *timeliness* - members highlighted that completing the project in a timely matter was important and considered that adding presentation to the current stage of the project might affect its completion.

Key discussion points for the session

- 10 EFRAG DCL included in agenda paper 07-02 contains the following main points reflecting the EFRAG position on the IASB's ED on supplier finance arrangements:
- (a) *General introduction* - EFRAG welcomes the IASB's exposure draft *Supplier Finance Arrangements*. At this stage, EFRAG constructively supports the IASB's project to enhance the transparency of reporting for supplier finance arrangements (i.e. to focus on the proposed disclosures as set out in the ED) and complement the existing disclosure requirements in IFRS Standards. However, EFRAG anticipates that further efforts are needed in terms of presentation and classification of such arrangements and encourages the IASB to consider possible improvements related to supplier finance arrangements in the future in other cross-related projects. EFRAG makes further suggestions of how to improve the reporting of supplier finance arrangements in Appendix 2;
 - (b) *Question 1 Scope* - EFRAG agrees with the proposed scope to focus on supplier finance arrangements and with the IASB approach to explain the characteristics of the type of arrangements included in the project scope;
 - (c) *Question 2 Disclosure objective and disclosure requirements* - EFRAG supports to add an overall disclosure objective and specific disclosure requirements in IAS 7. However, EFRAG recommends the IASB to consider some improvements to the proposed specific disclosure requirements such as:
 - (i) when disclosing the terms and conditions of the arrangement, to explain when and why the liability is classified as trade receivable or short-term debt;

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- (ii) to clarify whether the range of payment due dates in accordance with paragraph 44H(b)(iii) refers to payment due dates towards the supplier(s) or finance provider(s);
 - (iii) to consider whether there is a need to disclose separately the carrying amounts of liabilities depending on their classification as trade payables or a short-term debt;
- (d) *Question 3 Examples added to disclosure requirements* - EFRAG agrees with the IASB proposal to add an example within the liquidity risk disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*. EFRAG also agrees with the proposal to add supplier finance arrangements as an example in paragraph 44B of IAS 7 *Statement of Cash Flows*. However, EFRAG encourages the IASB to consider whether gross presentation of cash flows under supplier finance arrangements may provide more relevant information to users of financial statements. EFRAG suggests the IASB to at least include a cross-reference between paragraph 44F and paragraph 44B(da) of the ED to emphasise that non-cash changes under supplier finance arrangements is key information when gross up presentation in the statement of cash flows is not allowed;
- (e) *Appendix 2* – in Appendix 2, EFRAG suggests the IASB to consider further improvements to reporting for supplier finance arrangements in future projects in terms of presentation and classification of such arrangements. In particular, to consider:
- (i) whether further clarifications or improvements could be done within a separate and comprehensive project on *Primary Financial Statements*;
 - (ii) further improvements to the requirements in IFRS 9 *Financial Instruments* for supplier finance arrangements in the principle-agent area and derecognition requirements;
 - (iii) how the proposed disclosure approach under the ED fits with the approach taken in the IASB project *Disclosure Requirements in IFRS Standards - A Pilot Approach*.

More details on particular recommendations are included in Appendix 2 of the EFRAG DCL on this project.

Questions for EFRAG TEG

- 11 Does EFRAG TEG agree with the drafting of the cover note to the EFRAG DCL on IASB's ED *Supplier Finance Arrangements*? Does EFRAG TEG agree with the drafting of the EFRAG's response to the questions included in the IASB's ED *Supplier Finance Arrangements*?
- 12 Does EFRAG TEG agree to include Appendix 2 to the EFRAG DCL on IASB's ED *Supplier Finance Arrangements*? Does EFRAG TEG have any comments, suggestions of how to improve Appendix 2?
- 13 Does EFRAG TEG recommend the EFRAG DCL on the IASB's ED *Supplier Finance Arrangements* as set out in agenda paper 07-02 to the EFRAG Board for its consideration?

Next steps

- 14 Following the publication of the EFRAG DCL on supplier finance arrangements, EFRAG Secretariat is planning to conduct the following outreach activities to test the IASB's proposals on:
 - (a) *Scope* – to perform a field test with preparers to assess the impact of the IASB's approach to explain the scope of the project instead of define it. In

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addition, to test in practice whether all relevant arrangements fall within the scope of the project;

- (b) *Specific disclosure requirements* – to perform outreach with users of financial statements (e.g. focused on examples) to assess the relevance of the proposed disclosure requirements.
- 15 EFRAG Secretariat is planning to present the feedback from outreach activities and discuss a draft version of the EFRAG final comment letter on the project at the end of March 2022. In order to allow for better balance between meeting the IASB comment deadline and providing good input on the project, EFRAG Secretariat is proposing to have an additional EFRAG TEG meeting on 29 or 30 March 2022.

Agenda Papers

- 16 In addition to this cover note, agenda papers for this session are:
- (a) Agenda paper 07-02 – EFRAG DCL on *Supplier Finance Arrangements*; and
 - (b) Agenda paper 07-03 – The IASB’s ED on *Supplier Finance Arrangements* – for background only.