Feedback on outreach activities on Supplier Finance Arrangements Issues Paper

Objective

1 The purpose of this paper is to provide feedback to EFRAG TEG on outreach activities conducted on the IASB's Exposure Draft ED/2021/10 *Supplier Finance Arrangements* (the ED).

2 The feedback received will be used to form the EFRAG position to be reflected in its Final Comment Letter (FCL) on the ED's proposals.

Background

3 The IASB published its ED in November 2021. The ED proposes to require disclosures about supplier finance arrangements in order to improve the transparency of reporting and assess the effects of those arrangements on an entity's liabilities and cash flows. The ED's comment period ends on 28 March 2022.

4 EFRAG published its draft comment letter ('DCL') on the ED in January 2022. In its DCL, EFRAG broadly supports the IASB's project which increases conformity with existing disclosure requirements in IFRS Standards and is posing several questions to constituents on specific areas such as scope of the project, proposed disclosure requirements and aggregation of information for supplier finance arrangements. EFRAG DCL's comment period ended on 9 March 2022.

Feedback on SFA outreach

5 EFRAG organised the following outreach activities the IASB's ED on supplier finance arrangements (SFA):

(a) Questionnaire on the scope of SFA – public survey on the ED's proposals related to the scope of the project;

(b) Closed consultations with, professional organisation, users and credit rating agencies and a public meeting with national standard setters - EFRAG conducted 4 outreach events on the proposals included in the IASB's ED;

(c) Written consultation with EFRAG FIWG.

6 Appendix 1 provides a detailed list of outreach events.

7 In addition, EFRAG discussed and exchanged views on the ED's proposals in informal calls with ESMA and other national standard setters. ESMA's position is considered here in agenda paper 05-02. The paper 05-03 *Comment letter analysis* does not include their feedback as the comment letter was received after 14 March 2022.

8 EFRAG issued a [questionnaire] to receive feedback on scope. EFRAG received a total of 9 responses to its questionnaire (3 national standard setters, 2 preparers, 2 users, 1 enforcer and 1 auditor). A detailed questionnaire report is included in Appendix 2.

9 The feedback obtained from outreach activities is summarised below following the order of questions included in the IASB's ED.

General comment

10 The IASB's proposals to require disclosure of information about SFA that enable users of financial statements to assess the effects of those arrangements on the entity's liabilities and cash flows were broadly supported. The proposed disclosure requirements were seen as a tool to make SFA 'visible' for users of financial statements and assess their impact on entities' leverage and liquidity risk.

11 One participant generally agreed with the proposed scope of the project as it addressed the issue raised by users of financial statements in a targeted and timely manner. However, considered that as a second stage the IASB should address a broader project on IAS 7. They also acknowledged that classification and presentation matters in an entity's statement of financial position and statement of cash flows were not part of SFA project, however, encouraged the IASB to consider elevating in any final amendments the analysis set out in the IFRS Interpretations Committee's agenda decision published in December 2020.

Scope of disclosure requirements

Description of the characteristics of SFA as opposed to detailed definition

12 There was general support for the IASB's proposals on scope. The IASB's approach to describe rather than define SFA was welcomed for the following reasons:

(a) it would capture a wider range of SFA as there was a risk that new types of contracts might emerge;

(b) it would put the focus on describing important financing arrangements in a holistic way as opposed to a detailed definition which may prevent such an approach;

(c) it would limit structuring opportunities as the description of SFA targets the substance of the contact rather than its legal form; and

(d) a description of SFA was preferable to a strict definition because it suited better principle-based standards. Useful disclosures were already required from an IFRS 7 perspective, the description adds value that different type of contracts have to be considered.

Not all the agreements in scope increase liquidity risk

13 One jurisdiction noted that the current description of scope was vague. Paragraph BC7 only dealt with suppliers being paid earlier (collective factoring). The scope was wide, but some of the agreements described in the scope did not increase the liquidity risk of the entities. This standard setter is of the view only extension of payment terms and liquidity risk should require disclosures.

14 Some participants in the outreach considered that certain financing schemes providing an entity's suppliers with early payment terms (i.e. basic factoring arrangements where the reporting entity was a passive party to the arrangement) should not be considered within the scope of the project. Such arrangements allowed the suppliers to be paid earlier than the invoice date, however, did not extend the reporting entity's credit and therefore did not affect its liquidity risk. There was a major need for disclosures only when entities extended the credit limit of their suppliers thereby increasing their own funding. One EFRAG user panel member expressed the same view: he considered that

such arrangements did not raise significant liquidity risks. He was more concerned about SFA with extended payment terms.

Scope could be broader

15 It was recommended that the IASB should carefully consider that some financing arrangements were increasingly used in practice. Such arrangements (i.e. inventory finance arrangements, letters of credits, credit card mechanisms) were providing a different way to achieve credit extension by reporting entities.

16 Furthermore, it was acknowledged that inventory financing arrangements were closely related to SFA and it was not always easy to draw the line between debtor selling its receivables and an entity establishing a SFA for its suppliers. In such situations, distinguishing between SFA and factoring arrangements would depend on how the contract was drafted.

17 One participant suggested that entities could have motivations others than extended credit time to enter into SFA and those should be considered when determining whether the entity was in scope of the project.

Other comments

18 Suggestion was made to improve the SFA description by clarifying that SFA must be initiated by the paying entity.

19 One jurisdiction considered whether the characterisation of SFA was not de facto a definition for such arrangements. It was noted that BC11 of the ED provided scope exclusions (arrangements that finance receivables or inventories are out of the ED's scope) which were not defined by ED, therefore, it made it unclear what exactly was within the scope of the project.

20 One participant suggested to take a holistic view. SFA may include several contractual agreements between all or some of the three parties (entity, financial provider and supplier). The characteristics of those contractual agreements should be analysed together when considering the description of SFA in paragraph 44G of the ED.

21 One participant suggested that the IASB should develop educational materials for the various types of SFA.

22 One participant noted that the scope of the project considered just a few key ratios and a more holistic approach on a wider range of different key risk indicators such as presentation of cash flows in general, liquidity situation, concentration risk would be more beneficial.

23 The same participant commented that due to variety of SFA and the way those arrangements were structured in practice, it was possible that information about some SFA might be available for a reporting entity to determine whether it was within the scope of the project, however, information might not be available for other arrangements.

Questionnaire on the scope of SFA

24 EFRAG received a total of 9 responses to its questionnaire (3 national standard setters, 2 preparers, 2 users, 1 enforcer and 1 auditor). The main messages gathered from their responses are included below. A more detailed questionnaire report is included in Appendix 2.

25 A slight majority of the respondents considered supported the scope: the proposed description of SFA would result in targeted arrangements being captured within the scope of the project. Preparers responding to the questionnaire had mixed views.

26 Almost all of the respondents suggested to clarify the wording, i.e. considered that it would be helpful if the description would be expanded to clarify that SFA providing early

payment terms to suppliers and SFA providing extended credit terms to buyers should be within the scope of the project.

27 One preparer did not support the proposed scope: only arrangements that provide the entity with extended payment terms should be included in the scope.

28 A few respondents pointed out that some arrangements may not be captured within the scope. These are the following:

(a) Situations where an intermediary party purchases goods or services from a supplier and sells them to an entity with prolonged payment terms, acting therefore as a finance provider.

(b) Flexible funding arrangements including supply chain finance and dynamic discounting (possibility to pay earlier in exchange for a reduced price) so entities may switch between the two models as the need arises.

29 Almost all of the respondents, including the two preparers, considered that the receivables and inventory finance arrangements should be included in the scope of the project. A majority of them, including one preparer, considered that the IASB's proposals for SFA could be applied to these arrangements by analogy.

30 A slight majority of the respondents considered that entities would not have access to information on arrangements to which the reporting entity does not necessarily participate, such as arrangements between the finance provider and the supplier. Preparers responding to the questionnaire had mixed views on this matter.

Disclosure objective and disclosure requirements

Disclosure objective

31 Participants in the outreach supported the IASB's proposal to add an overall disclosure objective and specific disclosure requirements in IAS 7 *Statement of Cash Flows* to help users of financial statements assess the effects of SFA on an entity's liabilities and cash flows.

Terms and conditions of SFA

32 Most participants recommended that the IASB provide additional guidance on the granularity of the agreements to be considered. In particular the IASB should be more specific with disclosures related to terms and conditions of SFA. In practice, it was possible that reporting entities could have one master SFA and then slightly different conditions or nuances for different countries or currencies. In this respect, it was not clear what was the level of each SFA as required by the ED (whether the level of disclosures referred to the master SFA or to each of the amended master SFA).

33 Some participants observed that the benefits of SFA could relate not only to the timing of payment to suppliers but also extend to the amounts of liabilities under such arrangements including discounts and interest rates involved. More detailed information from the finance provider establishing the interest rate and date of payment to suppliers might be useful. One jurisdiction further suggested that if reporting entities could also benefit from a cash discount as a result of SFA rather than just an extension of payment terms the disclosures about SFA needed to be different.

34 Users highlighted that information about the terms and conditions of material arrangement was key to understand the economics behind the transaction along with the carrying amount of financial liabilities recognised in the reporting entity's statement of financial position. The users stated that they wanted to understand the impact of the SFA on extension of payment terms (by considering any agreement with suppliers and with the bank) and liquidity risk.

<u>Payments received by suppliers from finance provider</u>

35 Participants generally agreed that the proposed requirement to disclose information about the carrying amount of liabilities for which suppliers had already received payment from the finance providers might not be feasible as entities might not have this information depending on the structure of the SFA.

36 Moreover, the reporting entity might not have all the information required to be disclosed and might not even be aware of whether there was an arrangement between the finance provider and the supplier.

37 However, one participant considered that entities would generally be able to obtain this information from the finance provider.

<u>Range of payment due dates</u>

38 Majority of participants considered crucial to provide information on the time of payment to suppliers as well as the extended payment terms as a consequence of SFA in order to understand how cash flows changed due to changes in payment terms. Even if there was no SFA in place, information on average time of payment to suppliers was important to know and as well as its year-to-year variation.

39 Users observed that having a wide range of payment due dates was not very helpful as it did not provide the depth of information to understand the extended payment terms of the reporting entity. Thus, more detailed (disaggregated) information on payment due dates may be needed. Users also acknowledged that the range of payment terms might be a competitive term and carry sensitive information about the reporting entity. Alternatively, some users mentioned it would be useful to have the weighted average payment terms and the payment range to be broken down into economic payment terms.

40 Users also noted that information about the range of payment due dates of financial liabilities and trade payables was fundamental to their analysis. Users usually made a split between trade payables and financial debt when there was a significant extension of payment terms compared to the general payment terms (considered to be 90 days). Therefore, for each finance arrangement where the payment term was over 90 days, the portion of the liability related to over 90 days was classified as financial debt. Nonetheless, information about the standard payment terms (starting point) was still relevant to assess the level of extension of the payment terms and the significance of an entity's debt.

41 Furthermore, users and other participants suggested that reporting entities should be required to disclose extended payment terms both with suppliers and finance providers under SFA. This information was important to understand the economics behind the entire arrangement.

<u>Level of aggregation</u>

42 Most participants considered that the IASB's proposal to require disclosure of information for each SFA might lead to disclosure overload and not result in useful information for users of financial statements. Participants preferred to start with top-down aggregate information and only have more detailed disaggregation where necessary.

43 One jurisdiction noted that the process to identify similar terms and conditions, in order to aggregate SFA, was not clear and more application guidance or examples would be helpful.

44 One EFRAG user panel member considered that most users would be happy with information aggregated at a high level. Conversely, many other members considered that a high level of aggregation was not helpful to understand the economics of the

transactions and its impact on the extension of payment terms and liquidity risk, particularly when having a wide range of payment terms. Therefore, there must be also judgement applied with respect to applying materiality principle on aggregation.

45 One participant commented that providing disclosures for each SFA could also be difficult in situations where international groups with subsidiaries in different countries were likely to have a broad range of arrangements. Therefore, a compromise on the aggregation approach would likely be needed.

46 There was wide support for EFRAG's suggested approach to provide aggregated information first and only require disaggregation when this would result in relevant information. The EFRAG's aggregation approach would only fulfil users' information needs if the level of aggregation enables them to understand the economics of the transactions and its impact on the extension of payment terms and liquidity risk.

47 However, some users that made a split of the liability (between trade payables and financial liability) cautioned that if the information was aggregated, they might lose the detailed information about the range of payment due dates which was necessary to perform their analysis as explained in paragraph 40 above. Therefore, providing disaggregated information applying the materiality principle in IAS 1 would be crucial to meet their needs. It was suggested that the starting point for aggregation should not be the individual contract and applying the materiality principle in IAS 1 *Presentation of Financial Statements* would be a better approach.

48 One participant observed that the aggregation principle for SFA proposed in paragraph 44I of the ED was not in line with the materiality principle in IAS 1. There was a risk that in some situations entities might have SFA which were individually immaterial, however, material when aggregated. They suggested that the IASB should require aggregated information about immaterial SFA, even if the terms and conditions were not similar, analogous with paragraph B65 of IFRS 3 *Business Combinations*.

<u>Suggestions of how to improve the proposed disclosures requirements under SFA</u>

49 One participant noted that it was useful to know what the credit limit under the SFA was and what amount was still available to be used by the reporting entity. They also considered that it would be useful to disclose information about SFA providing an option for recourse. However, they shared the view that presenting separately liabilities that arise from SFA as EFRAG was suggesting in its DCL was not consistent with disclosures on the assets side (i.e. factoring of receivables) where there was no requirement for separate disclosure.

50 Furthermore, users made the following suggestions of how to improve the proposed disclosure requirements for SFA:

(a) the disclosures about SFA should be provided for multiple reporting periods in order to compare the effects of SFA over time to better understand the trends;

(b) provide disclosures about how SFA would affect reporting entity's profitability (i.e. affect profit margins of the statement of profit or loss) – users are interested in obtaining information on how these arrangements affected the profitability of companies, and particularly the gross margin;

(c) the proposed disclosures should be made simpler and disclose what the effects were of having a financial institution as an intermediary in SFA;

(d) some noted that it would be useful to have roll forward weighted average payment terms to assess the deviations of extended credit to the reporting entity as a result of the SFA being in place;

(e) some noted that it would be useful to provide weighted average increase of payment dates that have been extended on an entity level and how these payment terms had been trending over time. This might help entities to provide information to investors without compromising their competitive position;

(f) to disclose what was the credit amount within the extended credit terms.

51 One standard setter expressed concern about the excessive detail of information required in the IASB´s ED.

Examples added to disclosure requirements

<u>Gross presentation of cash flows arising from SFA</u>

52 Most participants acknowledged that addressing how to present cash flows arising from SFA was crucial. From a conceptual perspective, participants were of the view that the statement of cash flows should only reflect actual cash flows because having imputed cash flows and mandating gross presentation for SFA might have unintended consequences on other non-cash transactions.

53 Some participants highlighted that although gross presentation provided useful information to users of financial statements, it would undermine the fundamental concept of the statement of cash flows. They observed that there were many other non-cash transactions which qualified for similar treatment, therefore, they supported having disclosure about non-cash changes arising from SFA rather than presentation changes in the statement of cash flows and the statement of financial position. Participants recommended that the link between the statement of cash flows and the statement of financial position should be preserved. The impact on operating cash flows and the financing cash flows from such type of arrangements should become transparent. Suggestion was made that additional guidance on presentation of cash flows arising from SFA for both reverse factoring and simple factoring was necessary.

54 One jurisdiction commented that gross presentation on the statement of cash flows would be useful information in practice and there was not much difference between an overdraft account used to pay vendors and transfer made automatically through an SFA.

55 One user considered that it would be useful to obtain information that would help users adjusting the reporting entity's net debt. Most financial analysts looked for the amount of payables that should be relocated to gross debt. Suggestion was made to disclose a single line showing the extension in credit provided to the reporting entity as a result of SFA. However, the impact on operating cash flows and the financing cash flows from such type of arrangements should become transparent. Such information is useful for cash flow projections.

56 Participants acknowledged that addressing how to present cash flows arising from SFA was crucial as the finance provider in SFA was executing the cash flows on behalf of the reporting entity. Therefore, it was suggested that the IASB should have a comprehensive discussion on this point and open a project on IAS 7 in the future.

57 Moreover, it was hard to determine the effects on the statement of cash flows when the SFA were within a group.

58 One participant suggested that the ED should explicitly require specific disclosure requirements of the actual cash flows to the finance provider under SFA. In particular, such disclosures might include guidance on classification of cash flows under SFA in the statement of cash flows.

<u>Liquidity risk</u>

59 One participant fully supported EFRAG's recommendation in its DCL suggesting the IASB to add an explicit proposal that would require disclosure of concentration of risk to

specific supplier finance provider(s) instead of SFA in general. This was because the concentration risk was significant due to different practices by finance providers. The replacement risk could be significant when the reporting entity depended on a single financial provider and it might be practically impossible to replace it in a short-term which could impose liquidity pressure on the reporting entity.

60 Users also observed that it was important to know how diversified the funding of the reporting entity was with respect to having different finance providers in order to assess the risk of a cliff event (i.e. the bank refused to continue to provide financing).

61 One participant supported the position expressed in the EFRAG DCL that the current project did not completely address the wider issue of providing necessary transparency on liquidity risk and how entities leverage their working capital to effectively obtain finance. There was a need for a more comprehensive project on accounting for SFA in the future.

62 One standard setter was of the view liquidity risk disclosures should have greater prominence. They could be included in the IFRS 7 standard itself rather than in the implementation guidance.

Question for EFRAG TEG

63 Does EFRAG FR TEG have any comments/ questions on the feedback included in this agenda paper?

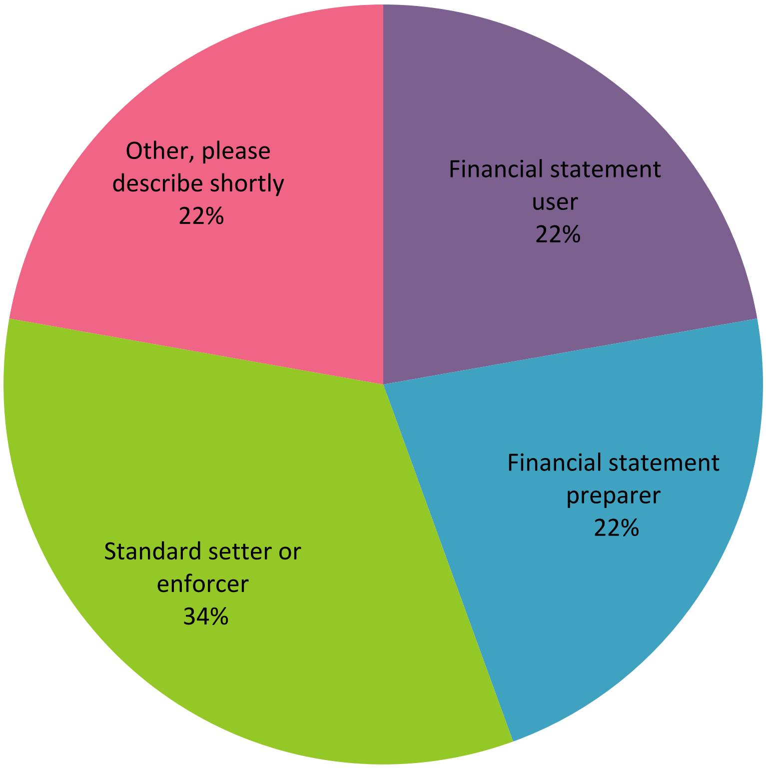
Appendix 1: List of outreach events where feedback has been taken into consideration in this paper on SFA

No	Participant	Description	Outreach event	Date
1	Accountancy Europe	Professional organisation	Closed consultation	8 February 2022
2	EFRAG CFSS/TEG	National Standard Setter	Public webinar	17 February 2022
3	EFRAG User Panel	Users panel	Closed consultation	17 February 2022
4	S&P Global	Credit Rating agency	Closed consultation	24 February 2022
5	ESMA	Regulator	Closed consultation	3 March 2022
6	EU constituents	Preparers	Online questionnaire	9 March 2022
7	EFRAG FIWG	Financial instruments panel	Written consultation	14 March 2022

Appendix 2: Report for Survey on scope of Supplier Finance Arrangements

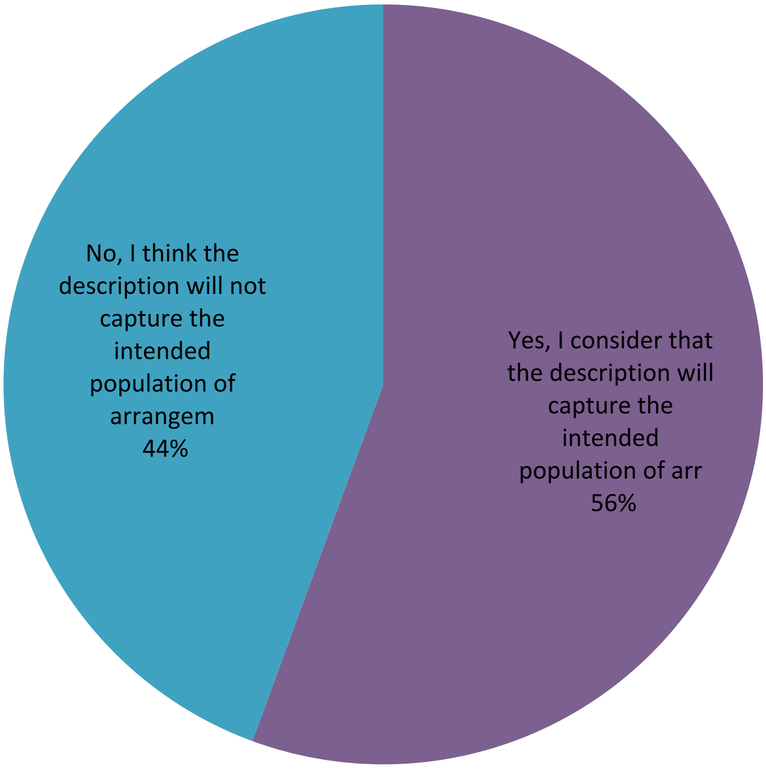
Survey on scope of Supplier Finance Arrangements

1.Type of respondent



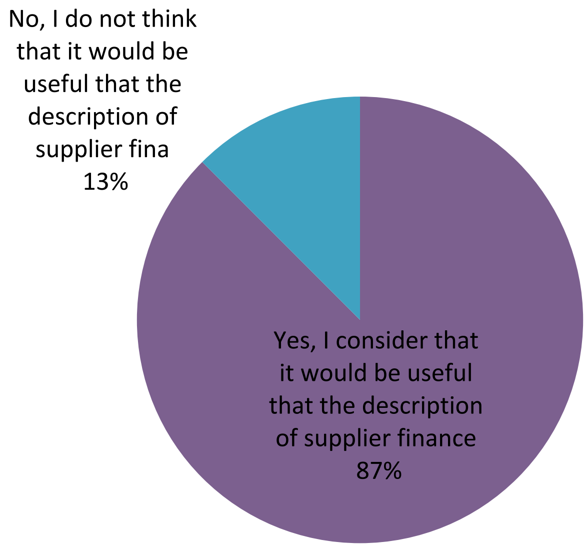
Value	Percent	Count
Financial statement user	22.2%	2
Financial statement preparer	22.2%	2
Standard setter or enforcer	33.3%	3
Other (1 auditor and 1 regulator)	22.2%	2
	Totals	9

2.Do you consider that the proposed description of supplier finance arrangements instead of a definition will result in targeted arrangements being captured within the scope of the project?



Value	Percent	Count
Yes, I consider that the description will capture the intended population of arrangements	55.6%	5
No, I think the description will not capture the intended population of arrangements	44.4%	4
	Totals	9

3.Do you consider that it would be useful if the description of supplier finance arrangements would be expanded to clarify that (i) arrangements providing early payment terms to suppliers and (ii) arrangements providing extended credit terms to buyers are both within the scope of the project?



Value	Percent	Count
Yes, I consider that it would be useful that the description of supplier finance arrangements is expanded	87.5%	7
No, I do not think that it would be useful that the description of supplier finance arrangements is expanded	12.5%	1
	Totals	8

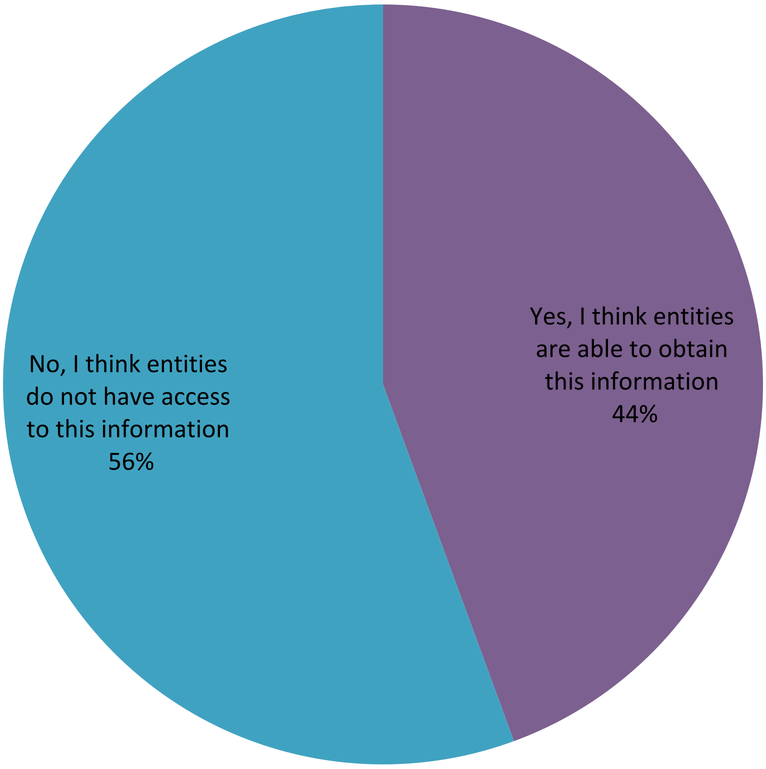
4.Please explain your view if you think that the description of supplier finance arrangements should not be expanded

Respondent	Response
Preparer	In our view, the description should only capture arrangements that provide the entity with prolonged payment terms. Therefore, the description should be narrower.

5.Have you identified any situations where the scope as described in the ED do not capture some supplier finance arrangements or alternatively, cases where some are unintentionally captured? Please explain and provide examples.

Respondent	Response
Auditor	Flexible funding - While supply chain finance and dynamic discounting are two separate solutions, some companies may wish to access both types of programs. For example, some businesses will have surplus cash available at certain times of the year, which can be deployed in a dynamic discounting program – but at other times of the year they may wish to invest cash elsewhere. One option is to implement two separate financing solutions from different vendors – but this may be less than ideal in terms of the supplier experience. Alternatively, vendors that offer a flexible funding model may allow buyers to switch seamlessly between the two models as the need arises.
Preparer	No
User	No
Preparer	As described above, we are of the opinion that arrangements that do not change the payment terms for the buyer in such an arrangement should not be captured by the description as they do not differ from the economic effect of factoring arrangements of the supplier. There may be situations where an intermediary party purchases goods or services from a supplier and sells them to an entity with prolonged payment terms and therefore acts as a provider of finance in between. It may be useful to elaborate on such arrangements as well.
Standard-setter	No.
Standard-setter	No

6.The ED's proposal assumes that the reporting entity has access to information about supplier finance arrangements to which the reporting entity does not necessarily participate, such as arrangements between the finance provider and the supplier. Do you consider that the assessment to be made by reporting entities to determine whether they are within the ED's scope would be feasible, considering the limited information that entities might have about supplier finance arrangements between the finance provider and supplier, in particular?

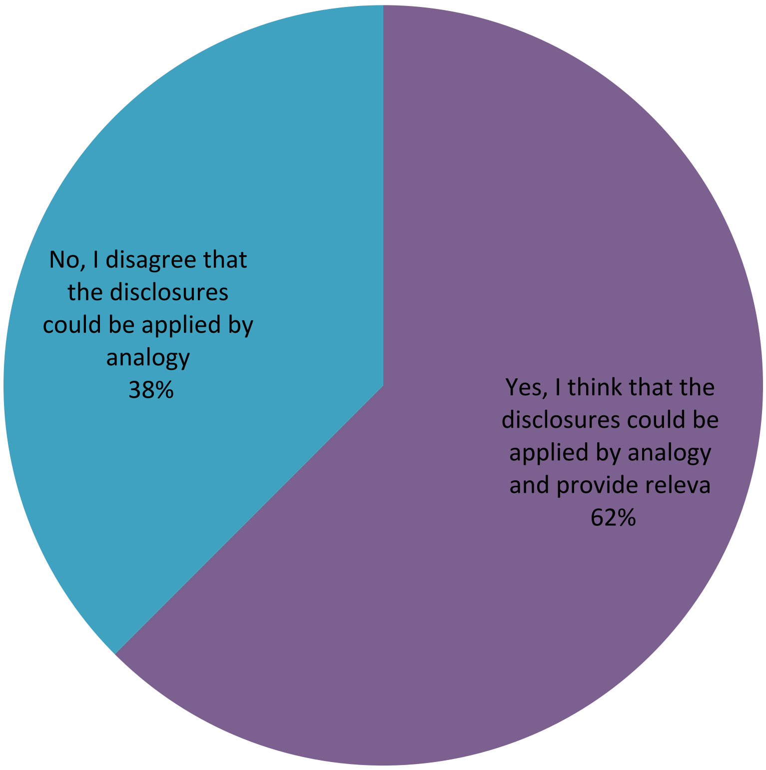


Value	Percent	Count
Yes, I think entities are able to obtain this information	44.4%	4
No, I think entities do not have access to this information	55.6%	5
	Totals	9

7.Please explain your view if you think that entities have limited information about the arrangement between the finance provider and the supplier

Respondent	Response
Standard-setter	We think that it is very difficult for an entity to have information about third parties' negotiations (supplier and finance provider).
Preparer	Since these arrangements can take a variety of forms, some of these arrangements may provide information to the reporting entity on whether or not a supplier has received earlier payment. However, this information will not be available to all entities and in all jurisdictions and may also be commercially sensitive.
Standard-setter	Normally, the entity would not have information about which suppliers have already received payment from the service providers [44H(b)(ii).
Standard-setter	I think that entities should only be required to report on supplier finance arrangements if they are party of the contractual arrangement or are beneficiary of a third-party agreement which results in an economic benefit for the reporting entity.
Regulator	We do not know at this time whether further effort is required on the part of the entities to collect the information required to disclose the information in point 44H (b) (ii).

8.Do you think that the IASB's proposals for supplier finance arrangements could be applied by analogy to arrangements about finance receivables and inventories and would therefore also address the user information needs about these types of arrangements?

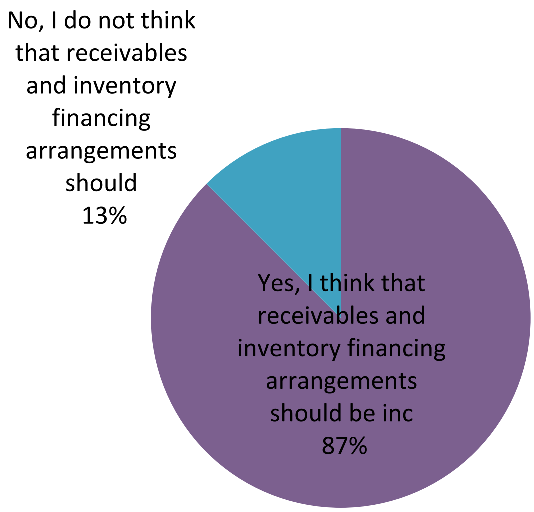


Value	Percent	Count
Yes, I think that the disclosures could be applied by analogy and provide relevant information to users about other types of arrangements.	62.5%	5
No, I disagree that the disclosures could be applied by analogy.	37.5%	3
	Totals	8

9.If you disagree, please explain your view in the box below

Respondent	Response
Standard-setter	We consider that it should be included in the scope but not applied by analogy.
Preparer	We assume that arrangements to finance receivables and inventories may take various forms. Therefore, we recommend analyzing these issues in more detail.
Standard-setter	While some of the circumstances might be similar, we believe that proposals are not sufficient to also cover finance receivables and inventories. There is also an overlap to the current post review process regarding IFRS 9.

10.Do you consider that receivables and inventory financing arrangements should be included in the scope of the project?



Value	Percent	Count
Yes, I think that receivables and inventory financing arrangements should be included in the scope	87.5%	7
No, I do not think that receivables and inventory financing arrangements should be included in the scope	12.5%	1
	Totals	8

11.If no, please explain your view

Respondent	Response
Standard-setter	We believe that these two topics should be covered by further guidance, but we believe that adding them to the project would postpone the finalization, which would not be beneficiary.

12.If yes, please explain what disclosures you would propose for such arrangements

Respondent	Response
Auditor	Those arrangements affect an entity's liabilities, cash flows and exposure to liquidity risk, too.
Standard-setter	The terms and conditions of the different receivables and inventory financing arrangements and the carrying amount recognized in the entity's statement of financial position.
User	There is a wide scope of financial instruments that provide effectively *bridge financing*, and I believe it would be better to analyze them as a package, rather than exclude some of them.
Preparer	We think that, depending on the characteristics of the arrangements, the economic effect may be very similar. As similar transactions should be presented and disclosed similarly, we would welcome if the project would take a more holistic approach.
User	-
Standard-setter	I think that economically both types of finance arrangements have comparable economic effects and therefore should be treated similar.