Supplier Finance Arrangements
Cover Note

Objective

1 The purpose of the session is to discuss and obtain EFRAG TEG-CFSS views on the proposals included in the IASB's exposure draft ED/2021/10 *Supplier Finance Arrangements*. The IASB published the exposure draft ('the ED') on 26 November 2021 with a comment deadline on 28 March 2022.

2 On 18 January 2022, EFRAG issued its DCL in response to the IASB's ED. On 17 February 2022, EFRAG TEG-CFSS discussed the IASB's proposals on supplier finance arrangements and the EFRAG's tentative position included in its draft comment letter on the project. This paper informs about the outreach result with the users and asks for the final input on the topic of disclosure objectives.

3 The updated feedback received on the proposed disclosure objective will be presented at the Accounting Standards Advisory Forum ('ASAF') meeting at the end of March 2022. Agenda paper 10-02 includes the ASAF agenda paper on supplier finance arrangements for background only.

Background of the IASB project

4 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.

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. In particular:

(a) on presentation – IFRS Standards allow for a variety of treatments on balance sheet depending on circumstances; and

(b) on disclosure – there are disclosures around liquidity risk and non-cash transfers on cash flow statement

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:

(a) to explain the type of arrangements within the scope, rather than include specific definitions;

- (b) to add qualitative and quantitative disclosure requirements to IAS 7 *Statement of Cash Flows*; and
- (c) to highlight existing disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*.

7 The ED on supplier finance arrangements does not cover:

- (a) arrangements that finance receivables or inventories because expanding the scope with those arrangements would require an assessment of the possible targeted information needs of users of financial statements and result in delaying the project; and
- (b) classification and presentation in the statements of financial position and cash flows – the IASB currently has a project on *Primary Financial Statements*. Presentation in the statement of cash flows related to supplier finance arrangements is a wider issue and would require opening a separate project.

Summary of the IASB's proposals on the project

8 In the Exposure Draft the IASB:

- (a) explains the type of arrangements to be included within the project's scope, instead of proposing detailed definitions.
- (b) proposes amending IAS 7 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. An example on proposed quantitative disclosures is included in Appendix 1; and
    - to provide qualitative information to help users of financial statements understand the risks that arise from supplier finance arrangements.
- (c) proposes that, to meet the proposed disclosure objectives, entities be required to disclose:
  - (i) the key terms and conditions of each supplier finance arrangement; and
  - (ii) for each supplier finance arrangement, at the start and end of the reporting period:
    - the carrying amount of financial liabilities that are part of the arrangement and the line items in the statement of financial position in which those financial liabilities are presented;
    - the carrying amount of financial liabilities disclosed for which suppliers have already received payment from the finance provider;
    - the range of payment due dates, expressed in time, of financial liabilities disclosed; and
  - (iii) the range of payment due dates, expressed in time, of trade payables that do not form part of a supplier finance arrangement;
- (d) proposes adding supplier finance arrangements as an example within the liquidity risk disclosure requirements in IFRS 7;

(e) requires entities to apply the proposed amendments retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*;

(f) provides no exemption for first-time adopters;

(g) permits an entity to apply the proposed amendments earlier than the effective date.

Summary of EFRAG's DCL

9 EFRAG TEG-CFSS was informed about the positions in EFRAG's DCL at its meeting on 17 February 2022.

10 EFRAG's tentative views included in its DCL are summarised below:

(a) *Scope* - EFRAG agrees with the project scope to focus on supplier finance arrangements. EFRAG also supports the proposal to explain the characteristics of the type of arrangements included in the project scope instead of providing a definition for supplier finance arrangements;

(b) *Disclosure objective and disclosure requirements* – EFRAG supports to add an overall disclosure objective and specific disclosure requirements in IAS 7. EFRAG further suggests that the disclosure objective is expanded to also include the effects of those arrangements on an entity's liquidity risk. EFRAG recommends the IASB to consider further improvements to the proposed disclosure requirements in its DCL;

(c) *Examples added to disclosure requirements* - EFRAG agrees with the IASB proposal to add supplier finance arrangements as an example in paragraph 44B of IAS 7 and within the liquidity risk disclosure requirements in IFRS 7. EFRAG recommends the IASB to consider adding an explicit proposal that would require disclosure of concentration of risk to specific supplier finance provider(s) instead of supplier finance arrangements in general. EFRAG makes further suggestions of how to improve the proposed improvements.

EFRAG TEG-CFSS discussion in February

11 On 17 February 2022, EFRAG TEG-CFSS discussed the IASB's proposals on supplier finance arrangements and the EFRAG's tentative position included in its draft comment letter on the project. Members made the following comments:

(a) *Scope* - most of EFRAG TEG-CFSS members welcomed the proposed scope and the IASB's approach to describe supplier finance arrangements which suited better principle-based standards. However, it was observed that the description of the scope was vague and included arrangements which did not increase the liquidity risk of reporting entities. It was also suggested that arrangements excluded from the scope of the ED should be defined, to clarify exactly what was within the scope of the project;

(b) *Aggregation of information* - members generally preferred to start with top-down aggregate information and then have more detailed disaggregation where necessary. Members asked for more application guidance or examples on what was the level of each supplier finance arrangement as suggested in the ED and how to identify similar terms and conditions when aggregating information;

(c) *Gross presentation in the statement of cash flows* - most of EFRAG TEG-CFSS members were of the view that the statement of cash flows should only reflect actual cash flows. It was acknowledged that gross presentation would provide useful information to users, however, it would undermine the fundamental concept of the statement of cash flows. Other members observed that:

(i) while the trade payable under SFA still existed with the reporting entity, the liability has been extinguished with the supplier, therefore there was a need to clarify how the cash flows should be reported under a principle-agent case; and

(ii) reporting non-cash changes arising from supplier finance arrangements was not sufficient as users would still get information about the operating cash flows which would be distorted;

Members discussed the possibility to disclose in the notes the adjustments to operating and financing cash flows due to supplier finance arrangements, i.e. to provide the gross-up information in the notes.

Feedback from users

12 In February 2022, EFRAG also conducted outreach on the proposals of the ED on supplier finance arrangements with users of financial statements. Users made the following comments:

(a) *Scope* - some users considered that arrangements providing an entity's suppliers with early payment terms should not be considered in the scope of the project as such arrangements did not extend the reporting entity's credit and therefore did not affect its liquidity risk;

(b) *Disclosure requirements*:

(i) terms and conditions - information about the terms and conditions of material arrangement to understand the economics behind the transaction and the carrying amount of financial liabilities recognised in the reporting entity's statement of financial position were key (it was not necessary to have this information for all the agreements, but for the material agreements);

(ii) range of payment due dates - disclosing a range of payment due dates was only part of the information needed, as it did not provide the depth of information to understand the extended payment terms of the reporting entity. The information needed is the amount of outstanding liabilities for which the entity is obtaining an extension in payment days, at least for the material agreements. However, they also considered that probably this information is a competitive advantage that could be sensitive to be disclosed. It would be more useful to provide the weighted average payment terms in order for users to perform their analysis. Furthermore, in their analysis, credit rating agencies usually make a split between amount attributable to trade payables and financial debt when there was a significant extension of payment terms compared to the normal(general) payment terms. For each finance arrangement, where the payment term was over 90 days, the portion of liability related to over 90 days was classified as financial debt. Additionally, credit rating agencies suggested that reporting entities should be required to disclose extended payment terms both with suppliers and finance providers under a supplier finance arrangement. This information was important to understand the economics behind the entire arrangement;

(iii) aggregation of information - the level of aggregation was not very helpful especially for large multinational groups which were likely to have a broad range of arrangements. However, if the information was aggregated and detailed information about the range of payment due dates was lost, users would need to obtain this data from the management (view of the credit rating agencies). The disaggregated information applying the materiality principle in IAS 1 would be crucial because of the 90-day criteria described above;

(c) *Gross presentation of cash flows arising from SFA* - users were of the view that gross presentation of cash flows under supplier finance arrangements was not particularly important as it did not provide the necessary information to adjust the reporting entity's net debt. Suggestion was made to disclose a single line showing the extension in credit provided to the reporting entity as a result of those arrangements;

(d) *Liquidity risk* - it was important to know how diversified the funding of the reporting entity was with the finance providers in order to assess the risk of a cliff event (i.e. the bank refused to continue to provide financing);

(e) *Profit margins* – users noted that due to supplier finance arrangements the timing of payment to suppliers could be shortened and as a result suppliers could grant a discount to the reporting entity. Consequently, this might have a positive effect on the entity's profit margins and users would be interested to know the effect of supplier finance arrangements on entity's profitability in addition to liquidity risk.

Questions for EFRAG TEG/CFSS

13 Do you agree with the proposed disclosure objective?

14 Do you think the proposed disclosures would enable investors to assess the effects supplier finance arrangements have on a company's liabilities and cash flows?

15 Which of the proposed disclosures do you expect will be most useful to you? Which would be least useful to you, or what do you think is missing?

16 Do you have any other comment?

Agenda Papers

17 In addition to this cover note, agenda paper 10-02 – ASAF Agenda Paper AP4 *Supplier Finance Arrangements* – has been provided for the session.

Appendix 1: Example on quantitative information

Annual financial statements for the reporting period ended 31 December 20X1

For each supplier finance arrangement	**At 31 Dec 20X0**	**At 31 Dec 20X1**
Carrying amount of liabilities part of the arrangement		
Presented as Trade or Other payables - Of which supplier have been paid by the finance provider	CU1,000 CU800	CU1,500 CU1,050
Range of payment due dates		
Liabilities that are part of the arrangement	80-90 days after invoice date	85-90 days after invoice date
Trade payables that are not part of the arrangement	60-65 days after invoice date	60-70 days after invoice date