Supplier Finance Arrangements
Key messages for EFRAG Draft Comment Letter

Objective

1 The purpose of this session is to obtain EFRAG TEG's views on key messages to be considered in the EFRAG Draft Comment Letter on the IASB's project *Supplier Finance Arrangements*.

2 The IASB is expected to publish an exposure draft on the project in November 2021. The publication will have a comment period of 120 days.

IASB's tentative decisions on the project

3 In June 2021 the IASB considered what it had heard from investors and analysts, the Committee and other stakeholders about investors' 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. 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).

(b) to explain the type of arrangements to be included within the project's scope, instead of proposing detailed definitions.

(c) 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.

(d) 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.

(e) to propose adding supplier finance arrangements as an example within the liquidity risk disclosure requirements in IFRS 7 *Financial Instruments: Disclosures.*

4 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.

5 At its July 2021 meeting, 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.

Key messages for EFRAG Draft Comment Letter

6 The EFRAG Secretariat supports a narrow-scope 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.

7 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's agenda decision and the IASB's project on disclosures are likely to improve significantly the reporting of financial information about supplier finance arrangements in the future.

8 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). Therefore, the EFRAG Secretariat highlights the linkage between these two projects.

(b) consider further improvements to the disclosures.

9 More specifically, the EFRAG Secretariat proposes the following key points to be considered in preparation of the EFRAG Draft Comment Letter on the topic:

Topic	Key messages
Narrow-scope project	**Narrow-scope standard-setting project on disclosures** • EFRAG 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. • The Committee agenda decision and the IASB's narrow-scope disclosure project are a step forward in addressing the issues highlighted by EFRAG in its comment letter to the IASB on *Primary Financial Statements* and are likely to improve significantly the reporting of financial information about supply chain financing arrangements in the future. • EFRAG considers that further guidance on classification and presentation of such arrangements in the statement of financial position and cash flows would be helpful to users of financial statements. • During the Third Agenda Consultation project, statement of cash flows was identified as one of the projects with higher priority. Part of the project should be to undertake a targeted project to improve aspects of the statement of cash flows, including information about non-cash movements, such as arising from supplier finance arrangements. • EFRAG also observes that there is an increasing number of arrangements related to financing of inventory which should be closely monitored by the IASB. • Additionally, EFRAG's consultation with regards to the Post-implementation Review of IFRS 9 *Financial Instruments* identified further issues with the classification and measurement of liabilities under supplier finance arrangements. In particular, there was a need for additional guidance on: ○ the principle-agent area; and ○ applying the derecognition requirements in IFRS 9 for liabilities when becoming part of supplier finance arrangement. • Therefore, EFRAG is of the view that the scope of the this project should be extended to include a wider area of attention as indicated above.

	Scope of the arrangements • EFRAG agrees with the scope of the project to focus on supplier finance arrangements. • EFRAG agrees with the IASB proposal to explain the type of arrangements to be included within the project's scope. However, it is important to test the scope of the project (e.g., outreach activities) to better understand whether all the relevant supplier finance arrangements would be in the scope of the project. • However, it should be clear that the disclosure requirements apply to all supplier finance agreements, including those that are presented as part of 'trade and other payables' (i.e. liabilities arising from operating activities and are part of the working capital used in the entity's normal operating cycle).
Overall disclosure objective in IAS 7	• EFRAG agrees to add an overall disclosure objective in IAS 7 to help users of financial statements understand the nature, timing, and uncertainty of cash flows arising from supplier finance arrangements.
Proposed disclosure requirements on IAS 7	• EFRAG notes that entities will have to apply different IFRS Standards and an agenda decision from the IFRS Interpretations Committee when accounting for and providing disclosures on supplier finance arrangements (i.e. multiple paragraphs in IFRS 7, IFRS 9, IAS 1, IAS 7 and Committees agenda decision). • EFRAG highlights the importance of helping management to apply the different IFRS Standard requirements related to classification, presentation and disclosures of such arrangements. • EFRAG is supportive of the direction of the project to improve disclosure requirements related to such arrangements. However, EFRAG considers that providing a comprehensive package of disclosures that includes all disclosures related to supplier finance arrangements (including integrating those mentioned in the IFRS Interpretations Committee agenda decision) would be useful. 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 separately a financial liability.
	• EFRAG highlights the importance of helping users finding the disclosures related to supplier finance arrangements. For example:
	    ○ by requiring the key disclosures on supplier finance arrangements to be located in a single place in the notes;
	    ○ 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).
	• EFRAG suggests the IASB to require entities to disclose where the amounts subject to supplier finance arrangements have been included in the primary financial statements (i.e. statement of financial position, statement of financial performance and statement of cash flows), taking into account different types of arrangements.
	• EFRAG suggests that the IASB considers whether there is a need to separate disclosures, depending on the classification of the liability as a trade payable or a short-term debt (similar to presentation on the face of the statement of financial position).
	• EFRAG is concerned that in certain cases a corporate entity might end up without any operating cash flows related to suppliers in the statement of cash flows (improving significantly operating cash flows metrics).
	• EFRAG highlights that gross-up information of supplier finance arrangements in the statement of cash flows may provide relevant information to users of financial statements (i.e. information about a cash outflow from operating activities and a cash inflow from financing activities when the invoice is factored by the financial institution; and a cash outflow from financing activities when the entity settles the liability). In particular, the IASB should clarify whether gross cash flows may exist if, for example, the financial institution acts as the entity's paying agent in a reverse factoring arrangement (including whether it would be an accounting policy).
	• EFRAG considers that it is fundamental to have disclosures on whether an entity has negotiated extended payment terms with its suppliers as a

	consequence of the supplier finance arrangement being in place. • EFRAG highlights the importance of having disclosures about the impact of supplier finance arrangements on leverage, liquidity and working capital cycle.
Proposed disclosure requirements on IFRS 7	• EFRAG agrees with the IASB proposal to require additional disclosures in IFRS 7 on liquidity risk associated with supplier finance arrangements. • EFRAG highlights the importance of having disclosures on liquidity risks related to the fact that an entity has concentrated part of its liabilities on a single finance provider (rather than a diverse group of suppliers) and that an entity (or its suppliers) has become reliant to the extended payment terms (or earlier payment) provided by the arrangement. Thus, if the arrangement is withdrawn, it could affect the entity's ability to settle liabilities when they are due.
Other comments: Presentation in the primary financial statements	• EFRAG considers that it would also be important to have further discussion on the consistency of reporting for supplier finance arrangements across different primary financial statements (statement of financial position, statement of financial performance and statement of cash flows). • EFRAG is of the view that there is still a need for standard-setting activity in the area of classification and presentation of supplier finance arrangements to better address the specificities of such arrangements. • EFRAG notes that developing a clear dividing line between trade payables and financial debt would be useful and encourages the IASB to try to develop a classification approach for liabilities under supplier finance arrangements. One possible way is to consider providing indicators such as who initiates the agreement, who bears the interest expense for the bank's intermediation in the arrangement, what is the usual maturity of liabilities under supplier finance arrangements etc. • On classification, EFRAG considers that more guidance is needed to help management apply the derecognition requirements in IFRS 9 for liabilities when becoming a part of a supplier finance arrangement. For example, it may be useful to develop 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). • On presentation, EFRAG highlights the importance of proper labelling these arrangements across the different financial statements (please see additional comments on labelling below).
Other comments: Presentation in the statement of financial position	• 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'). It is helpful for users that entities are required to provide better information on what trade payables will be paid under these arrangements and when (i.e. provide information similar to the maturity analysis for financial debt). • EFRAG recalls 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. • EFRAG also observes that the diversity in presentation of liabilities under supplier finance arrangements as trade payables or as financial debt is also a result of different legal frameworks that exist in various jurisdictions. For example, some jurisdictions do not allow the reclassification from operating to financing category. • EFRAG suggests that the IASB consider the possibility of always presenting separately liabilities that arise from supplier finance arrangements. For example, this separate line item could appear when there is a change to the usual characteristics of a 'trade payable' but this change is not sufficient to justify reclassification to financial liability.
Other comments: Presentation in the statement of profit or loss	• EFRAG highlights that 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. • Similarly, EFRAG highlights the importance of clarifying the presentation of income and expenses that arise from supplier finance arrangements when the entity settles invoices that are part of the arrangement on the due date as negotiated with its suppliers but suppliers can choose to be paid earlier than the invoice due date by the finance provider, at a discount.
Presentation in the statement of cash flows	• EFRAG considers that the linkage between the statement of financial position and the cash flow statement is important and should be preserved. Therefore, a gross presentation of cash inflows and outflows under supplier finance arrangements in the statement of cash flows could be useful when there is a principle-agent case.
Implementation	• If retrospective information is required, the IASB should provide sufficient implementation period for preparers as some of the information may be difficult to obtain, particularly the aggregate amounts proposed above. • However, the implementation period for the project should not be significantly extended as current diversity in practice would continue to be present. Following the publication of the IFRS IC's agenda decision in December 2020, entities had sufficient time to adjust their reporting for supplier finance arrangements, however, no significant changes were observed.

Question for EFRAG TEG

10 Does EFRAG TEG agree with the key points to be considered in preparation of the EFRAG Draft Comment Letter as detailed in paragraph 9 of this issues paper?