EFRAG
European Financial Reporting Advisory Group

Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the '[Express your views](#)' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by 9 March 2022.

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

28 March 2022

Dear Mr Barckow,

Re: Exposure Draft Supplier Finance Arrangements

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft ED/2021/10 *Supplier Finance Arrangements,* issued by the IASB on 26 November 2021 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG welcomes the IASB's exposure draft *Supplier Finance Arrangements*. The increased usage of such arrangements by European companies and the absence of specific disclosures on supplier finance arrangements under IFRS Standards and their variety in practice can significantly impair the usefulness of an entity's financial statements. The effects of such arrangements on an entity's liabilities and cash flows are not always obvious to users of financial statements and lack of disclosures related to supplier finance arrangements can result in obscured information and unequal comparisons across entities.

At this stage, EFRAG constructively supports the IASB's project to timely enhance the transparency of reporting for supplier finance arrangements (i.e. to focus on the proposed disclosures as set out in the ED) and increase conformity with existing disclosure requirements in IFRS Standards. EFRAG considers that rather than complementing the current requirements (IFRS 7, IAS 7, IAS 1), the proposals in this ED provide application guidance to them, when dealing with supplier finance arrangements.

EFRAG considers that the project does not completely address the wider issue of providing necessary transparency on liquidity risk and how entities leverage their working capital to effectively obtain finance; this includes presentation and classification in the statement of financial position, liquidity risk disclosures and relevance of the statement of cash flows in general. At a later stage, EFRAG anticipates that further efforts are needed in terms of reporting of such arrangements in the primary financial statements 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.

Project scope

EFRAG agrees with the project scope to focus on supplier finance arrangements because withdrawal of such arrangements could significantly affect an entity's ability to settle its liabilities when due. However, EFRAG recommends the IASB to remind entities of already existing disclosure requirements that apply to some types of financing arrangements and that the materiality principle is the overarching one for entities to consider when deciding what information would be relevant for users of financial statements.

EFRAG also agrees with the IASB proposal to explain the characteristics of the type of arrangements included in the project scope. Furthermore, EFRAG recommends the IASB to strengthen the description of supplier finance arrangements in paragraph 44G of the ED by clarifying that both supplier finance arrangements providing early payment terms to suppliers and supplier finance arrangements providing extending credit terms to buyers are within the scope of the project.

Disclosure objective and disclosure requirements

EFRAG supports to add an overall disclosure objective and specific disclosure requirements in IAS 7 to help users of financial statements assess the effects of those arrangements on an entity's liabilities and cash flows.

EFRAG also considers that providing a comprehensive package of disclosures that includes all disclosures related to supplier finance arrangements would be helpful to users. Additionally, EFRAG recommends the IASB to consider further improvements to the proposed disclosure requirements as explained in paragraph 2727 of Appendix 1.

Examples added to disclosure requirements

EFRAG agrees with the IASB proposal to add an example within the liquidity risk disclosure requirements in IFRS 7. This proposed disclosure will emphasise that such information is relevant for users to better assess the effects of supplier finance arrangements on an entity's exposure to liquidity risk and its risk management.

However, EFRAG observes that the concentration of liquidity risk may vary and 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 also agrees with the IASB proposal to add supplier finance arrangements as an example in paragraph 44B of IAS 7. This disclosure will emphasise that such disclosures are relevant for users to obtain better information about changes in liabilities arising from financing activities under supplier finance arrangements.

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. At a minimum, EFRAG suggests the IASB to include a cross-reference between paragraph 44F and paragraph 44B(da) of the ED as non-cash information is key when gross up presentation in the statement of cash flows is not allowed. Furthermore, EFRAG observes that the changes arising from supplier finance arrangements may be both cash and non-cash changes, therefore, EFRAG suggest the IASB to amend paragraph 44B(da) of the ED.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix 1.

If you would like to discuss our comments further, please do not hesitate to contact Ioana Kiss or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix 1 - EFRAG's responses to the questions raised in the ED

Question 1 – Scope of disclosure requirements

Notes to constituents – Summary of proposals in the ED

1 *The IASB proposes to explain rather than define supplier finance arrangements in scope of the ED. Such arrangements may have different structures and evolve over time. Therefore, the IASB is of the view that developing a detailed definition of supplier finance arrangements risks the definition becoming outdated as new practices and arrangements develop.*

2 *Instead, the IASB's approach to explain the type of arrangements that are within the scope of the proposed disclosures enables the ED's proposals to be framed in a way that captures the characteristics of supplier finance arrangements that give rise to particular information needs of users of financial statements.*

3 *Paragraph 44G of the ED includes the following description for supplier finance arrangements:*

'A supplier finance arrangement is characterised by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay the finance providers at the same date as, or a date later than, suppliers are paid. These arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date. Supplier finance arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements.'

4 *Paragraph BC8 of the Basis for Conclusions provides further examples of types of supplier finance arrangements that can be structured in different ways.*

5 *The proposed description for supplier finance arrangements aims to capture all arrangements that provide financing of amounts that an entity owes its suppliers (such as payables finance or reverse factoring arrangements). The IASB considers that variations in the form or labelling of such arrangement would not affect whether the disclosure requirements apply.*

6 *Furthermore, the scope of the ED does not consider arrangements that are linked directly to financing of an entity's receivables or inventory. The information needs related to those arrangements are unlikely to be fully aligned with user information needs about supplier finance arrangements and further assessment is needed to establish the users' information needs about receivables and inventory financing arrangements. Additionally, a wider scope of the ED might delay improvements to the required disclosures for supplier finance arrangements that are needed by investors and analysts.*

Question 1

The proposed amendments to IAS 7 and IFRS 7 do not propose to define supplier finance arrangements. Instead, paragraph 44G of the proposed amendments to IAS 7 describes the characteristics of an arrangement for which an entity would be required to provide the information proposed in the Exposure Draft. Paragraph 44G also sets out examples of the different forms of such arrangements that would be within the scope of the IASB's proposals.

Paragraphs BC5–BC11 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

EFRAG's response

EFRAG supports a narrow-scope project to develop clear and specific disclosure requirements for supplier finance arrangements that aims at enhancing transparency of reporting for such arrangements and increasing conformity with existing IFRS Standards.

EFRAG considers that the proposed new disclosure requirements provide application guidance when dealing with supplier finance arrangements rather than complementing the current requirements in existing IFRS Standards (IFRS 7, IAS 7, IAS 1). Therefore, EFRAG recommends the IASB to amend paragraph 44F of the ED to remind entities that there are already existing disclosure requirements that apply to some types of financing arrangements and that the materiality principle is the overarching principle for entities to consider when deciding what information would be relevant for users of financial statements. Furthermore, EFRAG notes that there is a risk of a possible narrow interpretation of the scope of IFRS 7 when applied to supplier finance arrangements.

EFRAG agrees with the project scope to focus on supplier finance arrangements. Such arrangements are increasingly used in practice and they can significantly affect an entity's ability to settle its liabilities when they become due, particularly when an entity significantly relies on supplier finance arrangements and concentrates its liabilities in a few finance providers.

EFRAG also agrees with the ED's proposal to explain the characteristics of the type of arrangements included in the project scope. Furthermore, EFRAG recommends the IASB to strengthen the description of supplier finance arrangements in paragraph 44G of the ED by clarifying that both supplier finance arrangements providing early payment terms to suppliers and supplier finance arrangements providing extending credit terms to buyers are within the scope of the project.

Notwithstanding its support for this project, EFRAG considers that the ED's proposals do not completely address the wider issue of providing necessary transparency on liquidity risk and how entities leverage their working capital to effectively obtain finance. Appendix 2 provides additional suggestions to the IASB of how to approach holistically the reporting for supplier finance arrangements.

7 EFRAG supports a narrow-scope project to develop specific disclosure requirements for supplier finance arrangements that provide relevant information to users of financial statements, focus the attention of preparers and auditors and facilitate enforcement by regulators.

8 EFRAG considers that the proposed disclosure requirements will result in increased conformity with existing IFRS Standards. The IASB notes in paragraph BC4 of the ED that the proposed new disclosure requirements complement the current requirements in IFRS Standards. EFRAG considers that rather than complementing the current requirements (IFRS 7, IAS 7, IAS 1), the proposals in this ED provide application guidance to them, when dealing with supplier finance arrangements (e.g. to provide guidance to entities regarding disclosures of their accounting policies and other information considering the overarching materiality principle when deciding what information would be relevant for users of financial statements). In this respect, EFRAG suggests the IASB to consider elevating the last sentence in

paragraph BC11 of the ED to form part of the main text of the Amendments as well as to refer to the requirements of IAS 1.

9 Additionally, EFRAG notes that there is a risk of a possible narrow interpretation of the scope of IFRS 7 which focuses on financial instruments. EFRAG observes that liabilities under supplier finance arrangements are not necessarily financial instruments and may not be captured within IFRS 7 disclosure requirements.

10 EFRAG agrees with the project scope to focus on supplier finance arrangements. Such arrangements are increasingly used in practice, and they can significantly affect an entity's ability to settle its liabilities when they become due.

11 EFRAG supports the scope as it effectively addresses the issue treated by the agenda decision *Supply Chain Financing Arrangements – Reverse Factoring* that was published in December 2020. EFRAG acknowledges that there might be other similar arrangements related to working capital and liquidity risk management for which there is a lack of disclosures (e.g. supplier inventory financing, receivables financing). EFRAG notes that such arrangements are increasingly used in practice and should be closely monitored by the IASB. Nevertheless, the information needs of users related to inventory financing arrangements are different from those for supplier finance arrangements. Therefore, EFRAG accepts the IASB's argument that widening the scope of the project to a broader range of financing arrangements related to an entity's working capital may delay the project.

12 EFRAG agrees with the IASB proposal to explain the type of arrangements to be included in the project's scope. EFRAG considers that the IASB's approach to describe the characteristics of supplier finance arrangements rather than define them would have the benefits to:

(a) eliminate the potential risk for the possible definition becoming outdated, and

(b) reduce any structuring opportunities related to drafting contracts between an entity and its supplier(s), and finance provider(s).

13 Furthermore, EFRAG suggests the IASB elevate paragraph BC8 of the ED to become part of the proposed amendments to IAS 7. This will strengthen the description of supplier finance arrangements in paragraph 44G of the ED and clarify that both supplier finance arrangements providing early payment terms to suppliers and supplier finance arrangements providing extending credit terms to buyers are within the scope of the project.

14 Notwithstanding its support for this project and the observations above, EFRAG considers that the project do not completely address the wider issue of providing necessary transparency on liquidity risk and how entities leverage their working capital to effectively derive finance; this includes presentation, classification and labelling in the statement of financial position, liquidity risk disclosures and relevance of the statement of cash flows in general. Appendix 2 provides additional suggestions to the IASB of how to approach holistically the reporting for supplier finance arrangements.

Question to Constituents

15 Do you consider that the proposed description of supplier finance arrangements in the IASB's ED/2021/10 *Supplier Finance Arrangements* will result in targeted arrangements been captured within the scope of the project? Have you identified any situations where supplier finance arrangements were not captured by the project scope, however, in your view, they should be?

Question 2 – Disclosure objective and disclosure requirements

Notes to constituents – Summary of proposals in the ED

16 *To satisfy the information needs of investors and analysts with respect to supplier finance arrangements, the IASB proposes the add an overall disclosure objective and specific disclosure requirements to the existing requirements in IAS 7 Statement of Cash Flows.*

17 *The overall disclosure objective included in paragraph 44F of the ED will enable users of financial statements to assess the effects of such arrangements on an entity's liabilities and cash flows.*

18 *The proposed new disclosure requirements in paragraph 44H of the ED are designed to complement the current requirements in IFRS Standards and provide users with information about:*

(a) *the terms and conditions of each supplier finance arrangement - that would identify the existence of supplier finance arrangements and explain their nature;*

(b) *the carrying amount of financial liabilities recognised in an entity's statement of financial position that are part of each supplier finance arrangement and the line item(s) in which those liabilities are presented – that would indicate the size of the arrangement and enable users to identify where in its statement of financial position an entity presents financial liabilities that are part of such arrangement;*

(c) *the carrying amount of financial liabilities recognised in an entity's statement of financial position for which suppliers have already received payment from the finance provider(s) – that would help users analyse an entity's debt and subsequent effects on its operating and financing cash flows. It would also provide information about the extent to which an entity has used extended payment terms or its suppliers have used early payment terms;*

(d) *the range of payment due dates of both financial liabilities that are part of each supplier finance arrangement and trade payables that are not – that would help users to assess the effect of each arrangement on the entity's days payable and cash flows;*

(e) *information at the beginning and end of each reporting period would help users of financial statements identify and assess changes and trends in the effect of each supplier finance arrangement on an entity's liabilities and cash flows.*

19 *Finally, an entity is required to disclose additional information about its supplier finance arrangements necessary to meet the overall disclosure objective in paragraph 44F of the ED. An entity is permitted to aggregate the information provided to meet the overall disclosure objective for different arrangements only when the terms and conditions of these arrangements are similar.*

Question 2

Paragraph 44F of the proposed amendments to IAS 7 would require an entity to disclose information in the notes about supplier finance arrangements that enables users of financial statements to assess the effects of those arrangements on an entity's liabilities and cash flows.

To meet that objective, paragraph 44H of the proposed amendments to IAS 7 proposes to require an entity to disclose:

(a) the terms and conditions of each arrangement;

(b) for each arrangement, as at the beginning and end of the reporting period:

(i) the carrying amount of financial liabilities recognised in the entity's statement of financial position that are part of the arrangement and the line item(s) in which those financial liabilities are presented;

(ii) the carrying amount of financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers; and

(iii) the range of payment due dates of financial liabilities disclosed under (i); and

(c) as at the beginning and end of the reporting period, the range of payment due dates of trade payables that are not part of a supplier finance arrangement.

Paragraph 44I would permit an entity to aggregate this information for different arrangements only when the terms and conditions of the arrangements are similar.

Paragraphs BC12–BC15 and BC17–BC20 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you agree with only parts of the proposal, please specify what you agree and disagree with. If you disagree with the proposal (or parts of it), please explain what you suggest instead and why.

EFRAG's response

EFRAG supports to add an overall disclosure objective in paragraph 44F and specific disclosure requirements in paragraph 44H of IAS 7 to help users of financial statements assess the effects of those arrangements on an entity's liabilities and cash flows.

EFRAG observes that providing a comprehensive package of disclosures that includes all disclosures related to supplier finance arrangements would be helpful to users. Additionally, EFRAG recommends the IASB to consider further improvements to the proposed disclosure requirements such as to disclose management's decision on presentation of liabilities and cash flows related to such arrangements, to require a designated note on supplier finance arrangements and use of consistent terminology, clarify the proposal on range of payment due dates and aggregation of information for liabilities under supplier finance arrangements. Further recommendations are included in paragraph 27 of the EFRAG DCL.

Disclosure objective

20 In general, EFRAG is supportive of the direction of the project to improve disclosure requirements related to supplier finance arrangements.

21 EFRAG agrees to add an overall disclosure objective in IAS 7 to help users of financial statements understand the effects of supplier finance arrangements on an entity's liabilities and cash flows.

22 EFRAG notes that the proposed disclosures provide a timely improvement towards a more transparent reporting for supplier finance arrangements. However, based on initial users' feedback, future efforts are needed to address also classification and presentation of those arrangements in the statement of financial position and in the statement of cash flows. Appendix 2 to this letter illustrates the issues that arise with those statements.

23 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 IC agenda decision) would be useful. For example, disclosing 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.

Specific disclosure requirements in IAS 7

24 EFRAG supports the proposed specific disclosure requirements in IAS 7 as such disclosures will enable users to better understand an entity's financial position and performance and show its level of debt resulting from such arrangements.

25 In addition, EFRAG highlights the importance of distinct disclosures related to supplier finance arrangements such as:

(a) requiring key disclosures on supplier finance arrangements to be located in a single place in the notes;

(b) 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).

26 EFRAG is of the view that the IASB proposals on improving disclosures related to supplier finance arrangements will result in the following benefits for users of financial statements:

(a) *explicit disclosure of supplier finance arrangements* - requiring information about the terms and conditions of each supplier finance arrangement would result in entities explicitly disclosing those arrangements with finance provider(s). Currently, the usage of such arrangements in practice is increasing, however, entities do not always reflect them in their disclosures and accounting policies;

(b) *size and location of liabilities* - disclosing the carrying amount of an entity's liabilities that are part of supplier finance arrangements and the line item(s) in which they are presented in the statement of financial position will give an indication to users about the size and location of liabilities being part of such arrangements;

(c) *entity's level of debt* – disclosing the carrying amount of liabilities that are part of supplier finance arrangements together with the carrying amount of these liabilities for which suppliers have already received payment from the finance provider(s) will be helpful to users to analyse an entity's level of debt and its effects on the operating and financing cash flows;

(d) *impact on days payable and cash flows* – disclosing the range of payment due dates of both financial liabilities that are part of each arrangement and trade payables that are not, will enable users to assess the extent to which operating cash flows improve as a result of the increased use of supplier finance arrangements by the entity;

(e) *usage of extended payment terms* – disclosing the carrying amount of financial liabilities for which suppliers have already received payment from the finance provider(s) would provide information about the extent to which the entity has used extended payment terms or its suppliers have used early payment terms. Users would be able to assess an entity's exposure to liquidity risk if the arrangements were no longer available;

(f) *trend analysis* – requiring information at the beginning and end of each reporting period would help users identify any changes and trends in the usage of supplier finance arrangements and their effects on an entity's liabilities and cash flows.

27 However, EFRAG recommends the IASB to consider the following improvements to the proposed specific disclosure requirements, in particular:

(a) when disclosing the terms and conditions of the arrangement, to consider whether it is useful to explain when and why the liability is classified as trade receivable or short-term debt. That is, an entity should disclose which terms and conditions lead to the classification as operating (i.e. trade payables) or financing (i.e. other financing liabilities);

(b) to clarify whether the range of payment due dates in accordance with paragraph 44H(b)(iii) refer to payment due date to the finance provider or payment due date to the supplier. This is particularly important considering that supplier finance arrangements can be structured in different ways as explained in paragraph BC8 of the ED. Preliminary views from users indicate that disclosure of payment terms based on contractual arrangements between an entity and its finance provider(s) would be more helpful;

(c) 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(similar to presentation on the face of the statement of financial position);

(d) to amend paragraph 44I of the ED to permit aggregation of information about different supplier finance arrangements not only when their terms and conditions are similar but also, in particular, when their payment due dates are similar;

(e) to amend paragraph 44H(a) to highlight that the materiality principle and the usefulness of information are the leading ones when reporting for supplier finance arrangements (i.e. to replace 'the terms and conditions of each supplier finance arrangement' with 'the *relevant* terms and conditions of each *material* supplier finance arrangement');

(f) to clarify the usage of the term 'financial liability' when applied to supplier finance arrangements. In particular, whether liabilities disclosed under such arrangements have to be presented as financial liabilities in the statement of financial position;

(g) to consider elevating the explanation in paragraph BC19 of the ED into the proposed amendments of IAS 7 in order to clarify that to the extent finance providers act as a paying agent on the entity's behalf the entity would be able to obtain this information from its paying agent.

Question to Constituents

28 Do you consider that the proposed requirement in paragraph 44H(b)(ii) of the ED to disclose information about the carrying amount of financial liabilities for which suppliers have already received payment from the finance providers is feasible to achieve for reporting entities? Are you aware of any difficulties with respect to meeting this disclosure requirement?

Question 3 – Examples added to disclosure requirements

Notes to constituents – Summary of proposals in the ED

29 The IASB proposes to add supplier finance arrangements as an example in paragraph 44B of the proposed amendments to IAS 7 to highlight the importance of providing information about non-cash changes in liabilities arising from financing activities that arise from such arrangements. Non-cash changes may not be *apparent to users of financial statements who find it difficult to understand the effects of supplier finance arrangements on an entity's operating and financing cash flows.*

30 *Supplier finance arrangements often give rise to liquidity risk by concentrating a portion of an entity's liabilities with one or a few finance providers rather than a diverse group of suppliers. Consequently, the withdrawal of such arrangement could increase pressure on an entity's cash flows and affect its ability to settle liabilities when they become due.*

31 *To enable users to assess the effect of supplier finance arrangements on an entity's exposure to liquidity risk and risk management, the IASB proposes to add supplier finance arrangements as an example within the liquidity risk disclosure requirements in IFRS 7 Financial Instruments: Disclosures to highlight the importance of providing liquidity risk information about these arrangements*.

Question 3

Paragraph 44B of the proposed amendments to IAS 7 and paragraphs B11F and IG18 of the proposed amendments to IFRS 7 propose to add supplier finance arrangements as an example within the requirements to disclose information about changes in liabilities arising from financing activities and about an entity's exposure to liquidity risk, respectively.

Paragraphs BC16 and BC21–BC22 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

EFRAG's response

EFRAG agrees with the IASB proposal to add an example within the liquidity risk disclosure requirements in IFRS 7. This proposed disclosure will emphasise (particularly to preparers) that such information is relevant for users as it will enable users to better assess the effect of supplier finance arrangements on an entity's exposure to liquidity risk and its risk management.

However, EFRAG observes that the concentration of liquidity risk varies depending on whether an entity has established supplier finance arrangements with only one finance provider or with a few different finance providers. Therefore, 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 also agrees with the IASB proposal to add supplier finance arrangements as an example in paragraph 44B of IAS 7. This disclosure will emphasise that such disclosures are relevant for users as it will enable them to obtain better information about changes in liabilities arising from financing activities under supplier finance arrangements.

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 in situations where a corporate entity may not report any operating cash flows under supplier finance arrangements and, therefore, significantly improve its operating cash flow metrics.

At a minimum, EFRAG suggests the IASB to include a cross-reference between paragraph 44F and paragraph 44B(da) of the ED as non-cash information is key when gross up presentation in the statement of cash flows is not allowed. Furthermore, EFRAG observes that the changes arising from supplier finance

arrangements may be both cash and non-cash changes, therefore, EFRAG suggest the IASB to delete the word 'non-cash' in paragraph 44B(da) of the ED.

Liquidity risk

32 EFRAG agrees with the IASB proposal to add an example within the liquidity risk disclosure requirements in IFRS 7 to highlight the importance of providing liquidity risk information about supplier finance arrangements. This will enable users to better assess the effect of such arrangements on an entity's exposure to liquidity risk and their risk management.

33 EFRAG highlights the importance of having disclosures on liquidity risks related to the fact that an entity concentrates 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 extended payment terms (or early payment) provided by the arrangement.

34 However, EFRAG observes that the concentration of liquidity risk varies depending on whether an entity has established supplier finance arrangements with only one finance provider or with a few different finance providers. Thus, if the arrangement is withdrawn, the entity could find itself in significantly different liquidity position based on how it diversifies its exposure to liquidity risk arising from different supplier finance arrangements with different finance providers. Therefore, 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.

Changes in liabilities arising from financing activities

35 When an entity does not report any operating cash flows because the gross up of the cash flows under supplier finance arrangement is not allowed, the effects of suppler finance arrangements on its cash flows may not be apparent to users of financial statements and obscure the reported information about such arrangements. Therefore, EFRAG is of the view that adding a disclosure in paragraph 44B of IAS 7 about changes in an entity's operating and financing cash flows is fundamental for users to understand the effects of such arrangements on an entity's cash flows.

36 However, EFRAG is concerned that in situations when a corporate entity does not report any operating cash flows related to payments to suppliers under supplier finance arrangements, the entity would significantly improve its operating cash flows metrics, which will result in unusual outcome in the statement of cash flows.

37 In such situations, the gross presentation of cash flows under supplier finance arrangements in the statement of cash flows may provide more 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 addition, preliminary discussion with users indicated that gross presentation of cash flows related to supplier finance arrangements would provide them with better understanding of the transaction compared to simply disclosing non-cash changes in liabilities under such arrangements as proposed in paragraph 44B(da) of the ED. In their view, prominence should be given to the presentation of cash flows under supplier finance arrangements which warrants consideration in the ED's proposals. Moreover, EFRAG recommends the IASB to remove the word 'non-cash' from 'non-cash changes arising from supplier finance arrangements' in paragraph 44B(da) of the ED as such arrangements can involve cash transfers as well.

38 Furthermore, the IASB should clarify whether gross cash flows may exist if, for example, the financial institution acts as an entity's paying agent in a reverse factoring arrangement (including whether it would be an accounting policy). Nonetheless, the IASB should consider to make cross-reference between paragraph 44F and paragraph 44B(da) of the ED as non-cash information is key when gross up presentation is not allowed.

Appendix 2 – Further recommendations on supplier finance arrangements

39 EFRAG supports the proposals included in the IASB's Exposure Draft ED/2021/10 *Supplier Finance Arrangements* and encourages the IASB to complete the project in a timely manner.

40 In general, the project will promote conformity with existing requirements, thus increasing the transparency of reporting for these arrangements and provide users with useful information about their effects on an entity's financial statements allowing for equal comparisons across entities.

41 This project is a step forward in addressing the issues highlighted by EFRAG in its comment letter on the IASB's project *Primary Financial Statements*. The IFRS IC's agenda decision and the IASB's project on supplier finance arrangements are likely to improve significantly the reporting of financial information about these arrangements in the future.

42 Nonetheless, EFRAG notes that entities will have to apply different IFRS Standards and an IFRS IC's agenda decision when accounting for and providing disclosures on supplier finance arrangements (i.e. multiple paragraphs in IFRS 7, IFRS 9, IAS 1, IAS 7 and IFRS IC's agenda decision). EFRAG highlights the importance of helping management to apply the requirements of different IFRS Standards related to classification, presentation and disclosures of such arrangements.

43 At this stage, EFRAG constructively supports the IASB's current project to timely enhance the transparency of reporting of supplier finance arrangements (i.e. to focus the project on the proposed disclosures as detailed in the ED). This will ensure that users will receive the information they need for supplier finance arrangements in a timely manner.

44 However, EFRAG considers that the project relates to the wider issue of presentation and classification in the statement of financial position, liquidity risk disclosures and relevance of the statement of cash flows in general. At a later stage, EFRAG anticipates that further efforts are needed in terms of reporting of such arrangements and the IASB should take the opportunity to:

(a) consider whether further clarifications or improvements could be done within a separate and comprehensive project (e.g. *Primary Financial Statements*). In particular, improvements that could help users easily assess the true level of borrowing from financial creditors (including net debt). Therefore, EFRAG highlights the linkage between these two projects;

(b) provide further application guidance, illustrative examples or implementation guidance on the requirements of IFRS 9 *Financial Instruments* for supplier finance arrangements in the principle-agent area and derecognition requirements for liabilities that become part of such arrangements;

(c) consider the need for a holistic review of how current disclosure requirements address the increased interest in liquidity risk and how entities leverage their working capital effectively when financing their activities;

(d) perform outreach on whether the proposed amendments to IFRS 7 satisfy users' information needs on liquidity risk.

45 EFRAG recommends the IASB to further consider 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). More details about further improvements related to reporting of supplier finance arrangements are included in the sections below.

46 Finally, EFRAG observes that the ED's proposed disclosure requirements provide rather application guidance on how to apply requirements of existing IFRS Standards (i.e. IAS 1, IAS 7, IFRS 7, IFRS 9) to supplier finance arrangements. EFRAG notes that the IASB' s narrow-scope project might confuse preparers that such disclosures are not required for other types of financing arrangements related to managing of an entity's working capital.

Statement of financial position

47 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. This could be addressed in separate related projects.

48 In the agenda decision issued by the IFRS IC it is clarified when an entity presents liabilities that are part of a reverse factoring arrangement as part of trade payables and when it should be presented separately. EFRAG observes that having a clear dividing line between trade payables and financial debt would be useful, however, it would be highly judgemental and difficult to achieve. Therefore, EFRAG suggests providing some indicators that would help entities determine the classification and presentation of liabilities in the statement of financial position under such arrangements. Possible indications that could be considered are: which entity initiates the agreement, which entity bears the interest expense for the bank's intermediation in the arrangement, what is the usual maturity of liabilities under supplier finance arrangements etc.

49 On presentation, EFRAG also considers that more guidance is needed to help management assess the presentation for liabilities when becoming part of supplier finance arrangements. . 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).

50 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 disclosures for financial debt).

51 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 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 IC when discussing the statement of cash flows, which refers to 'borrowings of the entity', but not when discussing the statement of financial position.

52 Users have also raised the issue of splitting the amount because classifying the entire payable as a loan payable would overstate the entity's borrowings.

53 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.

54 EFRAG suggests that the IASB consider the possibility of presenting separately liabilities that arise from supplier finance arrangements. For example, a 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.

Statement of financial performance

55 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 category.

56 Under some supplier finance arrangements, the entity settles invoices on the due date negotiated with its suppliers, but suppliers can choose to be paid earlier than the invoice due date by the finance provider, at a discount. In this case, EFRAG highlights the importance of clarifying the presentation of income and expenses that arise from such arrangements.

Statement of cash flows

57 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.

58 Additionally, EFRAG recommends the IASB to clarify how cash flows under supplier finance arrangements should be presented in the statement of cash flows, in particular, under paragraph BC8(a) and (b) of the ED and in light of the EFRAG's suggestion made in paragraph 13 of the EFRAG DCL.

Implementation

59 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.

60 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 in reporting were observed.