EFRAG
European Financial Reporting Advisory Group

EFRAG Board meeting
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Paper 03-01
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Supplier Finance Arrangements
Cover Note

Objective

1 The objective of the session is to:

(a) provide the EFRAG Board with a summary of the main proposals contained in the IASB's Exposure Draft ED/2021/10 *Supplier Finance Arrangements* (the 'ED');

(b) explain the initial input received from the EFRAG FIWG, the EFRAG User Panel and the summary of the EFRAG TEG discussion and its advice to the EFRAG Board; and

(c) discuss and approve a draft comment letter on the ED.

Background of the IASB project

2 In early 2020, the IFRS Interpretations Committee (IFRS IC) received a request about reverse factoring arrangements, more specifically:

(a) how an entity presents liabilities to which reverse factoring arrangements relate (i.e. how it presents liabilities to pay for goods or services received when the related invoices are part of a reverse factoring arrangement); and

(b) what information about reverse factoring arrangements an entity is required to disclose in its financial statements.

3 In a reverse factoring arrangement, a financial institution agrees to pay amounts an entity owes to the entity's suppliers and the entity agrees to pay the financial institution at the same date as, or a date later than, suppliers are paid.

4 Following research and outreach activities, the IASB Staff identified that entities report reverse factoring arrangements in diverse ways, and the extent to which entities provide information about reverse factoring arrangements can vary. Particularly in the statement of financial position (i.e. presentation of trade payables or other financial liabilities) and statement of cash flows (i.e. presentation of operating cash flow or financing cash flow). Finally, the research showed that entities often do not disclose the existence of reverse factoring arrangements.

5 In December 2020, the IFRS IC published an agenda decision which concluded that current principles and requirements in IFRS Standards provide sufficient guidance for entities to apply to reverse factoring arrangements.

6 However, in June 2021, after discussing the feedback received from investors and analysts, the IASB tentatively decided to add a narrow-scope standard-setting project to address investor information needs related to supplier finance arrangements, in particular to:

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

(b) add qualitative and quantitative disclosure requirements to IAS 7 *Statement of Cash Flows*;

(c) to highlight existing disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*.

7 The IASB published an exposure draft on the project on 26 November 2021 with a comment period of 120 days. The publication has a comment deadline on 28 March 2022. The ED can be consulted in agenda paper 03-03 and a summary of its proposals is included in the following section.

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; 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.

Background of EFRAG DCL

9 On 21 December 2021, EFRAG TEG discussed and agreed to recommend to the EFRAG Board the EFRAG draft comment letter ('the DCL') on supplier finance arrangements. Appendix 1 provides background to the position reached in the DCL.

Questions for EFRAG Board

10 Does EFRAG Board agree with the drafting of the cover letter to the EFRAG DCL on IASB's ED *Supplier Finance Arrangements*?

11 Does EFRAG Board agree with the drafting of the EFRAG's response to the questions included in the IASB's ED *Supplier Finance Arrangements*?

12 Does EFRAG Board agree to include Appendix 2 to the EFRAG DCL on IASB's ED *Supplier Finance Arrangements*?

Next steps

13 Following the publication of the EFRAG DCL on supplier finance arrangements, EFRAG Secretariat is planning to conduct the following outreach activities to test the IASB's proposals on:

(a) *Scope* – to test with preparers the approach to the scope (i.e. to explain the scope of the project instead of defining it). In addition, to test in practice whether all relevant arrangements fall within the scope of the project;

(b) *Specific disclosure requirements* – to perform outreach with users of financial statements (e.g. focused on examples) to assess the relevance of the proposed disclosure requirements.

14 EFRAG Secretariat is planning to present the feedback from outreach activities and discuss a draft version of the EFRAG final comment letter ('FCL') on the project with EFRAG TEG on 22 March 2022.

15 In order to meet the IASB comment deadline, EFRAG Secretariat is planning to submit to EFRAG Board the EFRAG FCL for approval through a written procedure between 23 March and 26 March 2022.

Questions for EFRAG Board

16 Does EFRAG Board agree to approve the final comment letter with written procedure? (the alternative being to doodle an additional meeting on 25 March in the afternoon or 28 March in the morning? (The IASB comment deadline is Monday 28 March 2022.)

Agenda Papers

17 In addition to this cover note, agenda papers for this session are:

(a) Agenda paper 03-02 – EFRAG DCL on *Supplier Finance Arrangements*; and

(b) Agenda paper 03-03 – The IASB's ED on *Supplier Finance Arrangements* – for background only.

Appendix 1: Background reading

Background of the EFRAG TEG discussions

1 On 21 December 2021, EFRAG TEG discussed the EFRAG draft comment letter on the project. Members expressed the following views on:

Scope

(a) in general, members supported the proposed narrow scope project based on the fact that it would increase conformity with existing IFRS Standards and would deliver relevant information to users of financial statements. It was important for the supplier finance arrangements project to be completed in a timely manner and the classification and presentation issues could be dealt with later in a separate and more comprehensive project. Thus, the EFRAG DCL should be constructive for the current project but anticipate what need to be done in the future;

(b) the EFRAG DCL should acknowledge that the ED's scope was based on concerns arising from IFRS IC's discussions and its agenda decision on the topic; and not to ask for broadening the scope of the ED;

(c) it would be useful to clarify the description of supplier finance arrangements by incorporating some of the examples included in the ED's *Basis for Conclusions* in the main paragraphs of the ED;

(d) to make a reference to the requirements in IAS 1 *Presentation of Financial Statements* by recommending the IASB to consider whether further improvements to proposed disclosure requirements were necessary; to note that entities are required to provide further information about other arrangements when such disclosures are material and result in relevant information for users;

(e) to note that IFRS 7 already covers disclosures related to liquidity risks arising from financing arrangements and the proposed disclosures under the ED provide application guidance of how to apply those to supplier finance arrangements;

(f) to note possible interpretation issues with the scope of IFRS 7 which focused on financial instruments while liabilities under supplier finance arrangements were not necessarily financial instruments and may not be captured under IFRS 7 disclosure requirements. However, the IASB should not delay the proposed amendments based on the points raised around IFRS 7 requirements;

Disclosure objective and disclosure requirements

(g) members expressed broad support for the disclosure objective as set out in the ED. They recommended acknowledging that the objective of the ED was wider than providing extended payment terms but referred to creating better financing position for entities using supplier finance arrangements;

(h) to suggest the IASB to amend paragraph 44I of the ED in order to ensure appropriate aggregation of information;

(i) to suggest the IASB to amend paragraph 44H(a) by replacing 'the terms and conditions of each supplier finance arrangement' with 'the relevant terms and conditions of each material supplier finance arrangement' in order to reduce the possibility of disclosure overload and clarify the aggregation principle when applied to supplier finance arrangements;

(j) to ask the IASB to clarify the usage of the term 'financial liability' when applied to supplier finance arrangements;

(k) to clarify the requirements related to disclosure of financial liabilities for which suppliers have already received payment from the finance providers and the range of payment due dates in paragraph 44H of the ED;

Examples added to disclosure requirements

(l) to use stronger wording and ask the IASB to add an explicit requirement that would require disclosure of concentration risk to specific supply chain arrangements under the proposed amendments to IFRS 7;

(m) to suggest to 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 transactions can involve cash transfers too;

Appendix 2

(n) the EFRAG DCL should to acknowledge 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;

(o) to suggest the IASB to perform outreach on whether the proposed amendments to IFRS 7 satisfy users' information needs on liquidity risk;

(p) to ask the IASB to clarify how cash flows under supplier finance arrangements should be presented in the statement of cash flows;

(q) to note in the EFRAG DCL that the ED rather provides application guidance on supplier finance arrangements;

(r) to put the focus of Appendix 2 on application guidance, illustrative examples or implementation guidance as derecognition and principal-agent requirements in IFRS 9 *Financial Instruments* were sufficiently clear.

Feedback from the EFRAG User Panel

2 On 7 December 2021, the EFRAG User Panel considered the proposals included in the IASB's ED on supplier finance arrangements and the keys messages for the EFRAG DCL revised with the comments made by EFRAG TEG during its November discussion. Members were broadly supportive of the direction of the project to require entities to provide specific disclosures related to supplier finance arrangements and made the following comments on:

(a) project scope – members expressed support for the IASB's approach to describe rather than define what supplier finance arrangements were. They considered the approach to be practical and less prone to structuring opportunities. However, it was noted that it might capture wider range of arrangements than anticipated. Furthermore, members commented that focusing the scope on supplier finance arrangements that lengthen the payment period would simplify the project;

(b) proposed disclosures – members expressed general supports for the proposed disclosure requirements under the ED and commented on:

(i) presentation of supplier finance arrangements - members considered that further improvements were necessary with respect to presentation, classification and measurement of liabilities under such arrangements. In particular:

- some members supported the IASB approach to start first by requiring disclosures about supplier finance arrangements and later consider improvements to the presentation and classification of these arrangements in other related projects in the future. This will result in a timely completion of the project and provide users with information about such arrangements;

- other members considered that the presentation of cash flows under supplier finance arrangements was important and warranted consideration by the IASB at this stage of the project;

(ii) comparability - members commented that they wanted to be able to understand how account payables would look like if supplier finance arrangements were not used;

(iii) range of payment due dates - users considered that contractual payment terms between the entity and the finance provider should be the starting point for disclosures related to due payment dates. This will provide users with information about when it has to pay the finance provider;

(c) timeliness - members highlighted that completing the project in a timely matter was important and considered that adding presentation to the current stage of the project might affect its completion.

Feedback from the EFRAG FIWG

3 On 8 November 2021, the EFRAG FIWG considered the IASB tentative decisions on the project and made the following comments:

(a) scope - some EFRAG FIWG members acknowledged that the scope of the project was limited to supplier finance arrangements as currently there is significant diversity in practice on the accounting for such arrangements. However, it was also noted that there was an increasing number of supplier inventory financing arrangements which the IASB should closely monitor;

(b) definition of supplier finance arrangements - it was important to properly define supplier finance arrangements as many similar arrangements could be found in practice; it was also 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;

(c) proposed disclosures - the EFRAG FIWG members commented that it was important that entities provide better information about what trade payables would be paid under these arrangements and when (i.e. provide information similar to the maturity analysis for financial debt). Members agreed that the direction of the IASB's proposed disclosures was the right one;

(i) presentation in the statement of financial position - the EFRAG FIWG members agreed that having a clearer boundary between trade payables and financial debt was important. However, members acknowledged that developing a dividing line was difficult (as it would always involve significant judgement) and might not be useful in situations where financial instruments regularly changed their characteristics. Members made the following practical observations:

- sometimes entities presented a separate category within trade payables for those that were under supplier finance arrangements. This separate line item would appear when there was a change to the usual characteristics of a 'trade payable' but this change was not sufficient to justify reclassification to financial liability;

- the extensive diversity of presentation of supplier finance arrangements as trade payables or as financial debt was also related to the difficulties preparers faced when accounting for these arrangements, particularly when considering the different legal frameworks that existed in different jurisdictions. For example, some jurisdictions did not allow the reclassification from operating to the financing category;

(ii) presentation in the statement of cash flows - members considered that the presentation linkage between the statement of financial position and the statement of cash flows was important and should be preserved. However, they were concerned that in certain cases an industrial entity might end up without any operating cash flows related to suppliers in the statement of cash flows (improving significantly operating cash flows metrics). In their view, a gross presentation in the statement of cash flows could be useful but only acceptable under a principle-agent case;

(d) implementation - members commented that the implementation period for the project should not be extended if it meant that bad practices would continue to be applied. 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.