

Mr Jean-Paul Gauzès
President
European Financial Reporting Advisory
Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: EFRAG's due process on the IASB's Exposure Draft Supplier Finance Arrangements

Dear Mr Gauzès,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process regarding the IASB's Exposure Draft ED/2021/10 *Supplier Finance Arrangements*. We are pleased to provide you with the following comments with the aim of improving the consistent application and enforceability of IFRS.

ESMA welcomes the initiative to require entities to disclose additional information about their supplier finance arrangements, as we expect that such information will enable users of the financial statements to assess the impact of those arrangements on an entity's liabilities, cash flows and financial risks.

ESMA shares the IASB's view that a detailed definition of supplier finance arrangements may be too narrow or become outdated and instead of a definition, a description of such arrangements should be included in IFRS. Moreover, this approach would reduce structuring opportunities. However, ESMA is concerned that the description included in paragraph 44G of the Exposure Draft may be too narrow to cover all relevant arrangements.

ESMA supports the disclosures on supplier finance arrangements proposed by the IASB. However, ESMA suggests that disclosures on non-similar finance supplier arrangements that are individually not material but are material in aggregate should also be required, as it would otherwise be possible that material information will not be included in the financial statements.

In addition, ESMA notes that EFRAG's comment letter includes proposals to require a designated note on supplier finance arrangements and to consider the possibility of separately presenting liabilities that arise from supplier finance arrangements. ESMA questions the



consistency of these proposals with the existing disclosure and presentation requirements in relation to the factoring of trade receivables.

ESMA emphasises that the concept of materiality is pervasive to the financial statements and does not support EFRAG's proposal to amend paragraph 44H(a) of the Exposure Draft to require information about terms and conditions to be provided only with regard to material arrangements.

Finally, in the interest of consistent application, ESMA considers it important that the IASB provides in IAS 7 additional guidance on the classification of cash flows related to the liabilities which are part of supplier finance arrangements.

More detailed comments on the ED are set out in Appendix to this letter. In case you have any questions or comments please do not hesitate to contact me or Evert van Walsum, Head of the Investors and Issuers Department (Evert.vanWalsum@esma.europa.eu).

Yours sincerely,

Verena Ross

Appendix

Question 1

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

Paragraphs BC5–BC11 of the Basis for Conclusions explain the Board'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.

1. ESMA agrees with the proposal to not define supplier finance arrangements and instead describe the characteristics of such arrangements as a detailed definition may be too narrow or become outdated.
2. However, ESMA proposes to clarify that the term "supplier financing arrangement" may include a range of contractual agreements between all or some of the following parties: entity, financial service provider, suppliers. These contractual agreements should be analysed together to determine whether the characteristics in paragraph 44G are met. ESMA is concerned that if the contracts are analysed separately (e.g. only the contractual agreement between the supplier and the financial service provider or only the agreement between the financial service provider and the entity), it may be argued that certain constructs used in practice do not meet these characteristics or some entities may structure their arrangements in order to avoid complying with the disclosure requirements.
3. Moreover, ESMA observes that the requirements in the Exposure Draft only address the disclosures on supplier finance arrangements and as such do not ensure sufficient transparency on this type of arrangements in the financial statements. ESMA considers it also important to provide clear guidance in IAS 1 on how an entity presents liabilities to pay for goods or services when the related invoices are parts of a supplier finance arrangement. If there is a risk that the publication of the proposed amendments to IAS 7 and IFRS 7 would be significantly delayed due to the need for a thorough discussion of the presentation issues, the IASB may consider including in IAS 1 (rather than in IAS 37) the guidance on which liabilities shall be presented as "trade and other payables" contained in the December 2020 Agenda Decision of the IFRS Interpretation Committee (IFRS IC) on supply chain financing arrangements.

Question 2

Paragraph 44F of the [Draft] 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 [Draft] 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 Board'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.

4. ESMA supports the disclosures on supplier finance arrangements proposed by the IASB. However, ESMA considers that providing information on whether the supplier finance arrangements include the possibility of recourse is important to enable users of financial statements to assess the risks inherent in those arrangements. Therefore, ESMA considers that entities should be required to disclose, if, in the event the entity is unable to settle the invoice, the finance provider has recourse against the supplier.
5. ESMA supports the requirement to disclose the carrying amount of financial liabilities for which suppliers have already received payment from the finance providers and shares the IASB's view expressed in paragraph 19 of the Basis for Conclusions that it would be generally possible for entities to provide this information and that the benefit of this information would outweigh the costs. In this context, ESMA observes that supply chain finance arrangements often include a credit limit. ESMA considers that entities should also disclose the credit limit and the available undrawn amount at the end of the reporting period in order to increase transparency on the availability of financing sources and their impact on liquidity risk. This information, which is readily available for the entity, would also provide indications on the entity's future expected usage of supplier finance arrangements.
6. Moreover, ESMA noted that according to paragraph 44I of the Exposure Draft an entity is permitted to aggregate the information provided to meet the disclosure objective in

paragraph 44F for different arrangements only when the terms and conditions of those arrangements are similar. ESMA is concerned that this requirement may lead to material information not included in the financial statements, particularly in situations when a number of non-similar supplier finance arrangements are individually not material but are material in aggregate. We suggest that disclosures on such arrangements should also be required to be provided on an aggregate basis (similarly to the requirement in paragraph B65 of IFRS 3, which requires disclosure of aggregated information for immaterial business combinations).

7. ESMA is aware that some constituents are debating whether the transfers from operating cash flows to financing cash flows resulting from supplier finance arrangements should be made transparent in the cash flow statement. Although this issue deserves a thorough debate, ESMA considers that it should not delay the final publication of the proposed amendments.
8. In addition, ESMA notes that EFRAG's comment letter includes proposals to require a designated note on supplier finance arrangements (paragraph 26) and to consider the possibility of separately presenting liabilities that arise from supplier finance arrangements (paragraph 59). ESMA questions the consistency of these proposals with the existing disclosure and presentation requirements in relation to the factoring of trade receivables. For the same reason ESMA does not support the gross presentation of cash flows under supplier finance arrangements (paragraph 42)
9. Finally, regarding EFRAG's proposal to amend paragraph 44H(a) of the Exposure Draft to highlight the materiality principle, ESMA emphasises that the concept of materiality is pervasive to the financial statements as a whole. Considering that paragraph 31 of IAS 1 clearly states that an entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material, ESMA is of the view that the changes proposed by EFRAG are unnecessary.

Question 3

Paragraph 44B of the [Draft] Amendments to IAS 7 and paragraphs B11F and IG18 of the [Draft] 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 Board'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.

10. ESMA supports the inclusion of 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.

11. In addition, ESMA notes that paragraph 16 of the Basis for Conclusions states (with reference to the December 2020 IFRS IC Agenda Decision on supply chain financing arrangements) that the entity – having considered the terms and conditions of the supplier finance arrangements – classifies the future cash outflow to settle the amount owed as arising from either operating activities or financing activities. ESMA considers it helpful if the IASB provided in IAS 7 additional guidance on the classification of the cash flows related to the liabilities which are part of supplier finance arrangements. This would help to reduce the diversity in practice and increase the comparability of financial statements.
12. Finally, ESMA encourages the IASB to develop educational material on the application of the IFRS requirements to various types of supplier finance arrangements.