STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	Supply Chain Financing—Reverse Factoring		
Paper topic	Item for continuing consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about supply chain financing arrangements.

2. The submission asks:

   (a) how an entity classifies its rights and obligations to which supply chain financing arrangements relate (for example, how it classifies its obligation to pay for goods or services received when those invoices are part of a supply chain financing arrangement); and

   (b) what an entity is required to disclose in its financial statements about supply chain financing arrangements.

3. The submission identified several types of supply chain financing arrangements. However, we understand from the submitter that the focus of the question is on reverse factoring arrangements. The information obtained from outreach and our own research also indicates that reverse factoring arrangements are the most common type of supply chain financing arrangement—with many using 'supply chain financing' to mean 'reverse factoring'. This paper therefore focuses on reverse factoring arrangements.

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4. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our analysis; and

   (c) ask the Committee whether it agrees with our recommendation:

      (i) not to add to its standard-setting agenda the classification of liabilities that are part of reverse factoring arrangements, and disclosures about liquidity risks arising from such arrangements. Instead, we recommend publishing a tentative agenda decision that outlines how IFRS Standards apply to those aspects of accounting for reverse factoring arrangements.

      (ii) to consider a narrow-scope standard-setting project to develop disclosure requirements for arrangements entered into to fund payables to suppliers.

5. The Committee discussed the prevalence of supply chain financing arrangements, the key terms of reverse factoring arrangements, and how entities account for reverse factoring arrangements at its April 2020 meeting. This paper does not repeat all the content of that paper. Agenda Paper 3 to the April 2020 Committee meeting can be found here.

Structure of the paper

6. This paper includes the following:

   (a) background information (paragraphs 8-16).

   (b) application of IFRS Standards (paragraphs 17-49).

   (c) should the Committee add a project to its standard-setting agenda:

      (i) overview (paragraphs 50-53);

      (ii) information needs of investors (paragraphs 54-57); and

      (iii) are investors' information needs met by applying IFRS Standards (paragraphs 58-70).

      (iv) staff conclusion (paragraphs 71-72)

(d) staff recommendation (paragraphs 73-74).

7. Appendix A to this paper contains the proposed wording of the tentative agenda decision.

Background information

Summary of submission and outreach conclusions

8. As explained in Agenda Paper 3 to the April 2020 Committee meeting (April agenda paper), reverse factoring arrangements involve (a) a financial institution paying an entity's suppliers amounts owed by the entity, and (b) the entity paying the financial institution. We understand that, in a few jurisdictions, the reverse factoring arrangements entered into legally release the entity from settling its liability to the supplier.

9. There are two broad types of reverse factoring arrangement—those primarily set up to enable:

   (a) an entity's suppliers to receive payment for their trade receivables before the due date (paragraph 10); and

   (b) an entity to settle trade payables later than the due date (paragraph 11).

10. Reverse factoring arrangements that enable an entity's suppliers to receive early payment of their trade receivables are the most common. This type of arrangement often does not extend the payment terms agreed between the entity and its suppliers and typically does not change other terms of the liability. Accordingly, the entity often pays the financial institution at the date on which payment was originally due to the supplier. However, in some cases, an entity and its suppliers may agree to extended credit terms—which may apply to all supplier invoices—at the same time as the entity sets up the reverse factoring arrangement. The entity may have been unable to obtain those extended credit terms if the reverse factoring arrangement were not in place.

11. In some other cases, an entity enters into a reverse factoring arrangement to enable it to settle trade payables later than it would have under the payment terms agreed

between the entity and its suppliers. The entity and the financial institution separately negotiate, and agree on, the date by which the entity pays the financial institution.

12. In both types of arrangement, information is typically exchanged between the parties to the arrangement though the use of a ‘platform’ established by the financial institution for the entity’s benefit. An entity uploads to the platform the invoice information it receives from a supplier and, if applicable, an irrevocable payment undertaking that confirms the entity’s intention to pay the invoice.

13. The outreach we performed suggests that entities account for reverse factoring arrangements differently; many said this is likely to reflect differences in the terms of the arrangements. We also understand that entities often do not disclose the existence, and effect, of reverse factoring arrangements in their financial statements.

Summary of discussions at the April 2020 Committee meeting

14. Committee members echoed the findings set out in the submission and from outreach that entities report reverse factoring arrangements differently, and the extent to which entities provide information about reverse factoring arrangements can vary. Committee members suggested different ways that financial reporting might be improved:

    (a) some members suggested highlighting existing disclosure requirements in IFRS 7 *Financial Instruments: Disclosures*, IAS 1 *Presentation of Financial Statements* and IAS 7 *Statement of Cash Flows*. Others suggested that it may also be necessary to develop new disclosure requirements that specifically capture reverse factoring arrangements. Some of these members said it may prove difficult to achieve consistency in liability classification (ie trade payables versus other financial liabilities) because of the evolving nature and differences in the types of arrangements.

    (b) some other members suggested considering the presentation of amounts related to these arrangements in the financial statements. These members thought consistency and transparency in presentation—in particular, in differentiating between trade payables and other financial liabilities in the

statement of financial position—could improve the information provided by entities about reverse factoring arrangements.

15. A few members mentioned the nature of the liability on origination of the invoice between the entity and supplier. These members said, in some instances, the invoice is agreed with the understanding that a reverse factoring arrangement will be used to facilitate payment. Therefore, in those cases, the liability (on invoice origination) might perhaps be considered a borrowing instead of a trade payable.

16. Our analysis and considerations in this paper address the matters raised by members at the April 2020 Committee meeting.

Application of IFRS Standards

17. In this section, we analyse how IFRS Standards apply to reverse factoring arrangements—specifically, how an entity treats such arrangements in the:
    - (a) statement of financial position (paragraphs 18-30):
        - (i) presentation (paragraphs 21-26);
        - (ii) derecognition (paragraphs 27-30);
    - (b) statement of cash flows (paragraphs 31-35):
        - (i) operating or financing cash flows (paragraphs 31-32);
        - (ii) gross presentation (paragraphs 33-35); and
    - (c) notes to the financial statements (paragraphs 36-48).

Statement of financial position

18. An entity recognises a liability when it receives goods or services from its supplier and does not settle the related invoice immediately.

19. Applying IAS 1, the entity is required to determine how to present that liability in its statement of financial position. This is the case regardless of whether the entity incurs the liability to pay for the goods or services before or after a reverse factoring

arrangement is in place. Paragraphs 21-26 discusses how an entity applies IAS 1 when determining how to present the liability.

20. In some instances, for example when an entity enters into a reverse factoring arrangement for an existing liability, the entity would assess whether to derecognise the existing liability applying the derecognition requirements in IFRS 9 *Financial Instruments* (see paragraphs 27-30).

Presentation

21. Paragraph 54 of IAS 1 requires an entity to include separate line items in its statement of financial position for ‘trade and other payables’ and ‘financial liabilities’. ‘Financial liabilities’ exclude amounts shown under ‘trade and other payables’ and ‘provisions’.

22. IFRS Standards do not explicitly define ‘trade and other payables’. However:

    (a) paragraph 11(a) of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that ‘trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier’.

    (b) paragraph 70 of IAS 1 explains that ‘some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity’s normal operating cycle’.

23. These requirements are helpful in assessing whether a financial liability should be presented as a trade payable. That is, to be presented as a trade payable, in our view a financial liability must represent a liability:

    (a) to pay for goods or services;

    (b) that is invoiced or formally agreed with the supplier; and

    (c) that is incurred as part of the working capital used in the entity’s normal operating cycle.

24. IFRS Standards contain no description of 'other payables'. However, paragraph 29 of IAS 1 states (*emphasis* added):

> An entity shall present separately each material class of similar items. An entity shall *present separately items of a dissimilar nature or function unless they are immaterial.*

25. An entity is required to present an item separately when it is material and has a dissimilar nature or function to other material items. The requirement in paragraph 54 to present the line item 'trade and other payables' therefore indicates that 'other payables' have a similar nature or function to 'trade payables'. Accordingly, for 'other payables' to be presented together with trade payables, in our view, those payables must be similar in nature or function to trade payables—that is, they are incurred as part of the working capital used in the entity's normal operating cycle.

26. In addition, paragraph 55 of IAS 1 requires the presentation of line items in addition to those listed in paragraph 54 when such presentation is relevant to an understanding of an entity's financial position. Paragraph 57 adds that line items are included in the statement of financial position when the size, nature or function of an item (or aggregation of similar items) is such that separate presentation is relevant to an understanding of the entity's financial position. Consequently, an entity would present liabilities subject to reverse factoring arrangements in a separate line item in its statement of financial position to the extent that the size, nature or function of those liabilities is such that separate presentation is relevant to an understanding of the entity's financial position. In assessing whether to present such liabilities separately, the entity assesses the amounts, nature and timing of those liabilities (paragraph 58 of IAS 1).

Derecognition

27. As mentioned in paragraph 20, when an entity enters into a reverse factoring arrangement for an existing trade payable, the entity assesses whether to derecognise that liability applying the derecognition requirements in IFRS 9.

28. Paragraph 3.3.1 of IFRS 9 states:

> An entity shall remove a financial liability (or part of a financial liability) from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

29. If the trade payable is discharged, cancelled or expires as a result of entering into the reverse factoring arrangement, an entity derecognises the trade payable and recognises a financial liability to the financial institution.

30. If an entity derecognises the trade payable and recognises a new financial liability to the financial institution, it would then assess, applying paragraphs 54-59 of IAS 1, whether the nature or function of the new financial liability is sufficiently different from that of trade and other payables (see paragraphs 23-25) to be presented separately. Factors an entity might consider for such an assessment include, for example:

    (a) whether the entity provides additional security to the financial institution that is unavailable to the supplier in the absence of that arrangement.

    (b) whether the terms of trade payables that are part of the arrangement are substantially different from those that are not (for example, trade payables have 60-day credit terms when part of the arrangement versus 30-day credit terms for those that are not).

Statement of cash flows

Operating or financing cash flows

31. IAS 7 contains requirements for the classification of cash flows in the statement of cash flows. Paragraph 6 of IAS 7 defines:

    (a) operating activities as the principal revenue-producing activities of the entity and other activities that are not investing or financing activities; and

    (b) financing activities as activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

32. There is no direct link between how an entity presents a financial liability in its statement of financial position and how it classifies cash flows arising from that liability in its statement of cash flows. However, in our view, in the context of reverse factoring arrangements an entity is likely to reach similar conclusions regarding presentation in both statements:

    (a) if an entity presents the liability as a trade payable, we would expect the entity to present cash outflows to settle the liability as operating cash flows. This is because we would expect such cash outflows to be considered as part of the entity's principal revenue-producing activities.

    (b) if an entity concludes that the financial liability subject to a reverse factoring arrangement is not a trade or other payable, we think it would do so on the grounds that the liability is not part of its working capital to be used in its normal operating cycle. Accordingly, we would expect the entity to conclude that cash outflows to settle such a financial liability are not operating cash flows, but instead financing cash flows.

Gross presentation

33. As we reported in the April agenda paper, some entities present reverse factoring transactions 'gross' in the statement of cash flows. In other words:

    (a) when the financial institution factors the invoice, the entity presents a cash outflow from operating activities and a cash inflow from financing activities; and

    (b) when the liability is settled, the entity presents a cash outflow from financing activities.

34. Paragraphs 43 and 44 of IAS 7 state (*emphasis* added):

> 43 *Investing and financing transactions that do not require the use of cash or cash equivalents shall be excluded from a statement of cash flows*. Such transactions shall be disclosed elsewhere in the financial statements in a way that provides all the relevant information about those investing and financing activities.

> 44 Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the statement of cash flows is consistent with the objective of a statement of cash flows as these items do not involve cash flows in the current period. […]

35. The terms of reverse factoring arrangements vary—for some arrangements, cash flows may arise for the entity when the financial institution factors the invoice. In those circumstances, an entity presents those cash flows in its statement of cash flows. Conversely, when cash flows do not exist, an entity excludes the transaction from its statement of cash flows and treats it as a non-cash transaction (see further discussion in paragraphs 44-46 of the paper).

Notes to the financial statements

36. There are a number of disclosure requirements that potentially apply to reverse factoring arrangements, including those requiring disclosure about:
    - (a) liquidity risks (paragraphs 37-43);
    - (b) changes in liabilities arising from financing activities (paragraphs 44-46); and
    - (c) significant judgements (paragraph 47-48).

Liquidity risks

37. Regardless of where they are presented in the statement of financial position, liabilities that are part of a reverse factoring arrangement are financial liabilities (ie they are contractual obligations to deliver cash to another entity). The disclosure requirements for financial liabilities in IFRS 7 therefore apply.

38. IFRS 7 defines liquidity risk as ‘the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset’. BC57 of the Standard further explains that:

> Liquidity risk, […], arises because of the possibility (which may often be remote) that the entity could be required to pay its liabilities earlier than expected.

39. In our view, liquidity risk arises in reverse factoring arrangements in two main ways:

    (a) the entity has concentrated a portion of its liabilities with one financial institution rather than a diverse group of suppliers. In addition, the entity may also obtain other sources of funding from the financial institution providing the reverse factoring arrangement. Therefore, if the entity were to encounter any difficulty in meeting its obligations, such concentration increases the risk that the entity would have to repay a significant amount quickly if the financial institution were to call the amounts outstanding to it.

    (b) some suppliers may have become accustomed to, or reliant on, early payment of their trade receivables. If the financial institution were to withdraw the reverse factoring arrangement, there is a risk that the entity’s suppliers would demand shorter credit terms. This could, in turn, affect the entity’s ability to settle those liabilities, particularly if the entity is already in financial distress.

40. Accordingly, we would expect an entity to disclose information about its exposure to liquidity risk arising from reverse factoring arrangements.

41. IFRS 7 requires an entity to disclose both qualitative and quantitative information about its exposure to liquidity risk arising from financial instruments. Paragraphs 33 and 34 of IFRS 7 require an entity to disclose how such liquidity risk arises, its policies and processes for managing the risk, summary quantitative data about its exposure to liquidity risk at the end of the reporting period, and concentrations of risk (which paragraph IG18 of IFRS 7 notes may arise, for example, from the repayment terms of financial liabilities or sources of borrowing facilities).

42. In addition, paragraph 39 of IFRS 7 requires an entity to disclose the following information about liquidity risks:

> (a) a maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
>
> (b) a maturity analysis for derivative financial liabilities. […]
>
> (c) a description of how it manages the liquidity risk inherent in (a) and (b).

43. Paragraph B11F of IFRS 7 identifies factors an entity might consider in providing the disclosure about liquidity risks required in paragraph 39(c). Paragraph B11F is not an exhaustive list of factors an entity might consider—nonetheless, it does contain some factors that in our view are relevant in the context of reverse factoring arrangements:

    (a) Paragraph B11F(a)—'whether the entity has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities) that it can access to meet liquidity needs'. Some reverse factoring arrangements could be considered a form of uncommitted loan facility. Such facilities are 'other lines of credit' that an entity could use to meet its liquidity needs.

    (b) Paragraph B11F(d)—'whether the entity has significant concentrations of liquidity risk in either its assets or its funding sources'. As noted in paragraph 39, a reverse factoring arrangement might concentrate a portion of an entity's liabilities with one financial institution. That arrangement could therefore result in the entity having a significant concentration of liquidity risk in its funding sources, which would be magnified if the entity also obtains other sources of funding from that same financial institution.

    (c) Paragraph B11F(e)—'whether the entity has internal control processes and contingency plans for managing liquidity risk'. This may be particularly relevant if the entity has obtained extended credit terms from the financial institution in a reverse factoring arrangement, or was able to agree extended credit terms with its suppliers because of the reverse factoring arrangement.

Changes in liabilities arising from financing activities

44. As mentioned in paragraph 35 above, if cash flows do not exist for the entity when the financial institution factors the invoice, an entity excludes the transaction from its statement of cash flows and treats it as a non-cash transaction. Paragraph 43 of IAS 7 requires an entity to disclose financing and investing non-cash transactions elsewhere in the financial statements in a way that provides all the relevant information about those transactions.

45. In addition, an entity is required to provide information to meet the disclosure objective in paragraph 44A of IAS 7. The objective requires an entity to:

> […] provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes.

46. Consequently, an entity would be required to provide such information for liabilities subject to reverse factoring arrangements to the extent that it classifies, or will classify, cash flows related to those liabilities as financing cash flows.

Significant judgements

47. Paragraph 122 of IAS 1 requires an entity to disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Depending on the terms of a reverse factoring arrangement and its significance for an entity, assessing the effect of reverse factoring arrangements on the entity's financial statements may involve such judgement, which would in turn require disclosure.

48. Further, paragraph 112(c) of IAS 1 requires an entity to provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them. Accordingly, if the use of reverse factoring arrangements has a material effect on an entity's financial statements, applying paragraph 112(c), the entity provides additional information about the reverse factoring arrangements that is relevant to an understanding of its financial statements.

Staff conclusion

49. We conclude that, applying IFRS Standards, an entity that has reverse factoring arrangements in place would:

    (a) determine where to present liabilities that are part of the arrangement in its statement of financial position applying IAS 1. The entity would assess whether the size, nature or function of those liabilities are dissimilar to other items, which would require separate presentation. To be presented as part of 'trade and other payables', the liabilities would need to be part of the working capital used in the entity's normal operating cycle.

    (b) if existing trade payables are part of the arrangement, determine whether to derecognise those trade payables and recognise new financial liabilities applying the derecognition requirements in IFRS 9.

    (c) determine whether cash flows related to the arrangement are part of the entity's operating activities or financing activities applying IAS 7.

    (d) disclose information about such arrangements, including:

        (i) the entity's exposure to liquidity risk arising from the arrangement applying IFRS 7.

        (ii) information to evaluate changes in liabilities subject to the arrangement to the extent it classifies, or will classify, cash flows related to those liabilities as financing cash flows applying IAS 7.

        (iii) the significant judgements it makes, and additional information, about the arrangement that is relevant to an understanding of its financial statements applying IAS 1.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the application of IFRS Standards to reverse factoring arrangements, summarised in paragraph 49?

Should the Committee add the matter to its standard-setting agenda?

Overview

50. To assess whether to add a standard-setting project on reverse factoring arrangements, we have considered the criteria in paragraphs 5.16 and 5.17 of the *Due Process Handbook*—namely:

    (a) Is the matter widespread and is it expected to have a material effect on those affected? In the light of the feedback received on reverse factoring arrangements (see April agenda paper), we have concluded that the matter is widespread and is expected to have a material effect on many entities that enter into these arrangements.

    (b) Is it necessary to change IFRS Standards to improve financial reporting? (Do IFRS Standard provide an adequate basis for an entity to determine the required accounting?)

    (c) Can the matter be resolved effectively and is it sufficiently narrow in scope? Will the solution be effective for a reasonable period of time?

51. In assessing the need for standard-setting, we considered user information needs based on feedback received from users of financial statements (see paragraphs 54-57 below). We then also considered whether application of the existing requirements in IFRS Standards meet those user needs (see paragraphs 58-70 below).

52. The paragraphs below consider standard-setting only with respect to possible disclosure requirements. We are not considering narrow-scope standard-setting on each of the following aspects of accounting for reverse factoring arrangements—instead, we are recommending a tentative agenda decision that outlines how IFRS Standards apply to these aspects—for the reasons explained:

    (a) The presentation of liabilities that are part of reverse factoring arrangements—IAS 1 already specifies presentation requirements for all assets and liabilities (as discussed in paragraphs 21-26 of this paper) and, in our view, these requirements provide an adequate basis for an entity to determine how to present liabilities that are part of reverse factoring

arrangements. Any project to address the presentation of liabilities would need to consider the requirements for *all* liabilities (or, at least, all financial liabilities), not only liabilities subject to reverse factoring arrangements. We note that as part of its project on *Primary Financial Statements*, the Board is proposing principles for aggregation and disaggregation to emphasise the existence of shared characteristics as a condition for classifying items—those proposals, if finalised, would be expected to be helpful with respect to presenting liabilities subject to reverse factoring arrangements.

(b) The derecognition of liabilities that are part of reverse factoring arrangements—IFRS 9 already specifies derecognition requirements for financial liabilities (as discussed in paragraphs 27-30 of this paper) and, in our view, these requirements provide an adequate basis for an entity to determine whether and when to derecognise trade payables that are part of reverse factoring arrangements. If the Board were to undertake a project to address the derecognition of financial liabilities, such a project would need to be a wider-scope project that would consider *all* financial liabilities, not only liabilities subject to reverse factoring arrangements.

(c) The presentation of cash flows under reverse factoring arrangements—IAS 7 already specifies requirements for the presentation of cash flows in the statement of cash flows (as discussed in paragraphs 31-35 of this paper) and, in our view, these requirements provide an adequate basis for an entity to determine how to present cash flows under reverse factoring arrangements. If the Board were to undertake a project to address the presentation of cash flows, such a project would need to be a wider-scope project that would consider *all* cash flows, not only cash flows under reverse factoring arrangements. We note that a number of stakeholders have already raised the topic of cash flows in the context of the Board's 2020 Agenda Consultation.

53. The paragraphs below set out our preliminary views on possible narrow-scope standard-setting. At this stage, we are seeking Committee members' views and suggestions regarding those preliminary staff views. We would then consider the

input from Committee members in preparing any future staff paper that would discuss this topic further.

The information needs of investors

54. A number of users of financial statements (investors) contacted us about reverse factoring arrangements, and we met with them to better understand their information needs. We spoke to five investors and analysts (two sell-side analysts, one buy-side analyst, two credit rating agencies) and two investment professional bodies.

55. Outreach with investors confirmed that information about reverse factoring arrangements is important to investors' decision-making. Investors need information that helps them to (a) assess the effect of reverse factoring arrangements on the financial position and cash flows of an entity, and (b) compare those effects across entities.

56. In particular, investors want to assess the extent to which an entity's working capital and liquidity are tied to the existence of reverse factoring arrangements—ie:

    (a) how the reverse factoring arrangement affects an entity's working capital management, both in terms of the total amount of trade payables subject to the arrangement and the effect on key financial ratios, such as free cash flows[1] or days payable[2].

    (b) how an entity's financial position would change if the reverse factoring arrangement were no longer available to the entity. Said differently, investors are interested in understanding the extent to which the reverse factoring arrangement affects the entity's liquidity.

[1] Free cash flows indicate how much cash is available to the entity before financial obligations. (https://www.investopedia.com/terms/u/unlevered-free-cash-flow-ufcf.asp)

[2] Days payable ratio indicate how well the entity's cash outflows are being managed by estimating the average number of days it takes the entity to settle invoices with its suppliers. (https://www.investopedia.com/terms/d/dpo.asp)

57. To help achieve their objective(s), investors would like information that helps them understand:

    (a) the total amounts subject to reverse factoring arrangements, including those that have been factored by financial institutions and those that have not.

    (b) where, and how, an entity has classified associated amounts in the statements of financial position and cash flows—for example, understanding whether and why these liabilities are classified as trade payables or other financial liabilities.

    (c) the nature of reverse factoring arrangements, including any credit term extensions, the effect of the arrangement on the entity's days payable ratio and the duration of that effect (for example, to understand whether improvements in the ratio is one-off or expected to occur in future periods).

    (d) the risks to which the entity is exposed, for example liquidity risks from reverse factoring arrangements and how the entity manages those risks.

    (e) the financial institution involved in the reverse factoring arrangement.

Are investors' information needs met by applying IFRS Standards?

58. In our view, IFRS Standards include requirements that address some investor needs. In particular, to the extent relevant to an understanding of its financial statements, an entity would:

    (a) present separately liabilities that are subject to reverse factoring arrangements;

    (b) disclose the accounting policy it applies to such liabilities; and

    (c) provide information about its exposure to liquidity risk arising from reverse factoring arrangements.

59. However, in our view, the information an entity provides applying existing requirements may not meet *all* investor needs. In particular, investors may be unable to obtain the information they need about the nature of reverse factoring arrangements and how the arrangements affect the entity's working capital. In the absence of

specific disclosure requirements on these aspects, there is a risk that comparability is hindered because it is unclear which entities enter into these arrangements and the effects of the arrangements on the financial statements. Accordingly, in paragraphs 60-70, we consider additional disclosure requirements that, in our view, might help investors obtain information that would be useful for their analysis.

Overall approach for additional disclosure requirements

60. If narrow-scope standard-setting were to be undertaken, we would propose that any new disclosure requirements should apply to arrangements an entity enters into to fund payables to its suppliers, rather than for example only arrangements labelled as 'reverse factoring arrangements'. This is because we are aware of many different naming conventions for reverse factoring arrangements. We also understand that these arrangements can be structured to achieve a desired outcome. As a consequence, our proposed approach would capture arrangements that are economically similar to reverse factoring arrangements and would avoid the need to define 'reverse factoring arrangements'.

61. Further, we would propose specific disclosure requirements that aim to directly address investor information needs described in paragraph 57.

62. We think any additional disclosure requirements on arrangements entered into to fund payables to suppliers should set out:

    (a) an overall disclosure objective. This would prompt an entity to consider whether the overall set of information provided in complying with the specific disclosure objectives meets investor information needs. This could, for example, prompt an entity to provide additional, entity-specific information that may not be directly captured by specific disclosure objectives.

    (b) specific disclosure objectives. These objectives would require entities to apply judgement in assessing whether the information is material to their financial statements and will meet specific investor information needs. These objectives will provide a more granular application of the overall disclosure objective and underpin particular disclosure requirements.

(c) disclosure requirements required to meet each specific disclosure objective. These requirements would be explicitly linked to the specific disclosure objectives.

Disclosure objectives and requirements

63. The following paragraphs identify the possible disclosure objectives and requirements that could be developed for arrangements entered into to fund payables to suppliers.

Overall disclosure objective

64. We think the overall disclosure objective could focus on the cash flow effects of arrangements entered into to fund payables to suppliers.

65. In addition, we think investors would be interested in understanding the risks that could result in potential variability of the entity's cash flows—ie we think the risks investors are referring to in paragraph 57(d) are not limited to liquidity risks.

66. Accordingly, our preliminary view is that an overall disclosure objective for any amendment could require an entity to disclose information that enables users of financial statements to understand the nature, timing, and uncertainty of cash flows arising from the arrangements it enters into to fund payables to its suppliers.

Specific disclosure objectives and requirements

67. We could develop three specific disclosure objectives to provide a more granular application of the overall disclosure objective.

68. The first specific disclosure objective could require an entity to disclose information that identifies, and explains the nature of, the arrangements it enters into to fund payables to its suppliers. An entity could be required to disclose the following information when necessary to meet this specific disclosure objective:

(a) the rationale for entering into the arrangements.

(b) a description of the nature of the arrangements, including any extensions to the credit facility available to the entity.

(c) restrictions or conditions, if any, imposed on the entity as a result of the arrangements.

(d) the total amount of liabilities the entity has committed towards these arrangements.

(e) information about the reasons for any changes in the amount in (d) during the reporting period.

69. The second specific disclosure objective could require an entity to disclose information about the extent of risks (for example, credit risk, liquidity risk) arising from arrangements it enters into to fund payables to its suppliers. An entity could be required to disclose the following information when necessary to meet this specific disclosure objective:

(a) the exposure to risks and how they arise.

(b) the entity's objective, policies and processes for managing the risks and the methods used to measure the risks.

(c) any changes in (a) or (b) from the previous period.

Consistent with our analysis in paragraphs 37-43, we think an entity might provide the information necessary to meet this specific disclosure objective applying the requirements in IFRS 7. Consequently, it could be helpful to provide a cross-reference to the applicable requirements in IFRS 7.

70. The third specific disclosure objective could require an entity to disclose information that explains how arrangements it enters into to fund payables to its suppliers affects the entity's financial position and cash flows during the reporting period. An entity could be required to disclose the following information when necessary to meet this specific disclosure objective:

(a) the significant judgements, and changes in those judgements, in determining where to present amounts included in the statements of financial position and cash flows.

(b) amounts included in the statements of financial position and cash flows, including the line items in which they are presented.

(c) information that may be necessary to understand the change in the amounts in (b).

Staff conclusion

71. We conclude that amending IFRS Standards to include additional disclosure requirements would provide useful information to investors about arrangements an entity enters into to fund payables to its suppliers. Paragraphs 60-70 provides our preliminary views on the possible standard-setting project.

72. In our view, the scope of such a project would be narrow-in-scope—in particular, we note that investor information needs have already been identified and time would not need to be spent in defining reverse factoring arrangements.

Staff recommendation

73. Based on our assessment of the Committee's agenda criteria in paragraphs 5.16 and 5.17 of the *Due Process Handbook*, we recommend the following:

    (a) not to add a standard-setting project on the classification of liabilities that are part of reverse factoring arrangements, and disclosures about liquidity risks arising from such arrangements. Instead, we recommend publishing a tentative agenda decision that outlines how IFRS Standards apply to those aspects of accounting for reverse factoring arrangements.

    (b) a narrow-scope standard-setting project is considered to develop disclosure requirements for arrangements entered into to fund payables to suppliers, as described in paragraphs 60-70 above.

74. Appendix A to this paper sets out the proposed wording of the tentative agenda decision.

Questions 2–4 for the Committee

2. Does the Committee agree with our recommendation not to add to its standard-setting agenda the classification of liabilities that are part of reverse factoring arrangements and disclosures about liquidity risks arising from such arrangements?

3. Does the Committee have any comments on the proposed wording of the tentative agenda decision in Appendix A to this paper?

4. What are Committee members' views on a possible narrow-scope standard-setting project to develop disclosure requirements for arrangements entered in to fund payables to suppliers? Do Committee members have comments or suggestions regarding the preliminary staff views set out in paragraphs 60-70 of this paper?

Appendix A—proposed wording of the tentative agenda decision

Supply Chain Financing—Reverse Factoring

The Committee received a request about the presentation and disclosure of reverse factoring arrangements. Specifically, the request asked:

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

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

Reverse factoring arrangements involve a financial institution paying an entity's suppliers amounts owed by the entity and the entity paying the financial institution.

Presentation in the statement of financial position

IAS 1 *Presentation of Financial Statements* specifies requirements for the presentation of liabilities in an entity's statement of financial position. Paragraph 54 requires an entity to present 'trade and other payables' separately from other financial liabilities because, if material, they are sufficiently different in nature or function to warrant separate presentation (paragraph 57 of IAS 1).

Paragraph 11(a) of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* states that 'trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier' and paragraph 70 of IAS 1 explains that 'some current liabilities, such as trade payables…are part of the working capital used in the entity's normal operating cycle'.

The Committee therefore concluded that an entity presents a financial liability as a trade payable only when (a) it represents a liability to pay for goods or services, (b) it is invoiced or formally agreed with the supplier, and (c) it is part of the working capital used in the entity's normal operating cycle.

Paragraph 29 of IAS 1 requires an entity to 'present separately items of a dissimilar nature or function unless they are immaterial'. Paragraph 57 specifies that line items are included

in the statement of financial position when the size, nature or function of an item (or aggregation of similar items) is such that separate presentation is relevant to an understanding of the entity's financial position.

Accordingly, the Committee concluded that, applying IAS 1, an entity presents:

a. other payables together with trade payables only when those payables have a similar nature or function to trade payables—ie when those other payables are part of the working capital used in the entity's normal operating cycle; and

b. liabilities that are part of a reverse factoring arrangement separately from other financial liabilities when the size, nature or function of those liabilities is such that separate presentation is relevant to an understanding of the entity's financial position. In assessing whether to present such liabilities separately, an entity considers the amount, nature and timing of those liabilities (paragraph 58 of IAS 1).

In making the assessment specified in paragraph 58 for liabilities that are part of a reverse factoring arrangement, the Committee observed that an entity might consider factors, such as:

a. whether it provides additional security to the financial institution that is unavailable to suppliers in the absence of the arrangement.

b. whether the terms of liabilities that are part of the arrangement are substantially different from those that are not (for example, 60-day credit terms for liabilities that are part of the arrangement compared to 30-day credit terms for those that are not).

Derecognition of an existing financial liability

When an entity enters into a reverse factoring arrangement for an existing liability to pay for goods or services from its supplier, the entity assesses whether to derecognise that liability (and recognise a new liability) applying paragraph 3.3.1 of IFRS 9 *Financial Instruments*. The extinguishment of a financial liability—ie when the obligation specified in the contract is discharged, cancelled or expires—results in derecognition of the liability.

An entity that derecognises a trade payable to a supplier and recognises a new financial liability to the financial institution determines how to present that new liability in its

statement of financial position applying IAS 1 (see above under the heading 'Presentation in the statement of financial position').

Presentation in the statement of cash flows

IAS 7 *Statement of Cash Flows* defines (a) operating activities as 'the principal revenue-producing activities of the entity and other activities that are not investing or financing activities', and (b) financing activities as 'activities that result in changes in the size and composition of the contributed equity and borrowings of the entity'.

An entity that has entered into a reverse factoring arrangement determines whether to classify cash flows under the arrangement as cash flows from operating activities or cash flows from financing activities. The Committee observed that an entity's assessment of how to present the related liabilities in its statement of financial position is likely to be helpful in determining whether cash flows arise from operating or financing activities. For example, if an entity considers the related liability to be a trade payable that is part of the working capital used in the entity's principal revenue-producing activities, the entity presents cash outflows to settle the liability as arising from operating activities in its statement of cash flows. In contrast, if an entity considers that the related liability is not a trade or other payable because the liability represents borrowings of the entity, the entity presents cash outflows to settle the liability as arising from financing activities in its statement of cash flows.

Investing and financing transactions that do not require the use of cash or cash equivalents are excluded from an entity's statement of cash flows (paragraph 43 of IAS 7). Consequently, to the extent there is a cash inflow and cash outflow when an invoice is factored as part of a reverse factoring arrangement, an entity presents those cash flows in its statement of cash flows. To the extent there are no cash flows involved in a financing transaction of an entity, the entity discloses the transaction in a way that provides all the relevant information about the financing activity (paragraph 43 of IAS 7).

Notes to the financial statements

Paragraph 44A of IAS 7 requires an entity to provide 'disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes'. The Committee

observed that such disclosure is required for liabilities that are part of a reverse factoring arrangement if the cash flows for those liabilities were, or future cash flows will be, classified as cash flows from financing activities.

IFRS 7 *Financial Instruments* defines liquidity risk as ‘the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset’. The Committee observed that liquidity risk often arises when reverse factoring arrangements are in place because:

a. the entity has concentrated a portion of its liabilities with one financial institution rather than a diverse group of suppliers. The entity may also obtain other sources of funding from the financial institution providing the reverse factoring arrangement. Therefore, if the entity were to encounter any difficulty in meeting its obligations, such concentration increases the risk that it may have to pay a significant amount, at one time, to that one counterparty.

b. some suppliers may have become accustomed to, or reliant on, earlier payment of their trade receivables under the reverse factoring arrangement. If the financial institution were to withdraw the reverse factoring arrangement, there is a risk that those suppliers would demand shorter credit terms. This could, in turn, affect the entity’s ability to settle liabilities, particularly if the entity is already in financial distress.

Paragraphs 33 and 34 of IFRS 7 require an entity to disclose how liquidity risk arises, its objectives, policies and processes for managing the risk, summary quantitative data about its exposure to liquidity risk at the end of the reporting period, and concentrations of risk. Paragraphs 39 and B11F of IFRS 7 specify further requirements and factors an entity might consider in providing liquidity risk disclosures.

An entity applies judgement in determining the extent to which it provides any additional disclosures about the effect of reverse factoring arrangements on its financial statements. In this respect, the Committee observed the following:

a. assessing how to present liabilities and cash flows related to reverse factoring arrangements may involve judgement. An entity discloses such judgement if it is part of the judgements that management has made that have the most significant

effect on the amounts recognised in the financial statements (paragraph 122 of IAS 1).

b. reverse factoring arrangements may have a material effect on an entity's financial statements. An entity provides information about reverse factoring arrangements in its financial statements to the extent that such information is relevant to an understanding of any of them (paragraph 112 of IAS 1).

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for the entity to determine the presentation of liabilities that are part of reverse factoring arrangements and the information to disclose about liquidity risks that arise in such arrangements. Consequently, the Committee [decided] not to add these matters to its standard-setting agenda.