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Project	Supplier Finance Arrangements	
Paper topic	Whether to undertake narrow-scope standard-setting	

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Introduction and purpose of this paper

1. The IFRS Interpretations Committee (Committee) received a submission about supply chain finance arrangements from the credit rating agency, Moody’s Investor Services (Moody’s), in January 2020. That submission asked:

   (a) how an entity presents liabilities to pay for goods or services received when the related invoices are part of a supply chain finance (or reverse factoring) arrangement; and

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

2. In response to that submission, the Committee published the Agenda Decision *Supply Chain Financing Arrangements—Reverse Factoring* in December 2020 (reproduced in Appendix A to this paper).

3. Moody’s said in the submission that fewer than 5% of entities it rates disclose information about the use of supply chain finance arrangements and their effects, and yet reports on the use of such arrangements would imply that a much higher percentage of entities are using these arrangements.

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4. Moody's noted the challenge in comparing entities that do not disclose the existence and use of supply chain finance arrangements. Other investors and analysts—both in comment letters (in response to the tentative agenda decision) and in outreach meetings—also informed us of a lack of information in financial statements about supply chain finance arrangements and the need for further information to perform their analyses.

5. This paper therefore analyses feedback and input received from investors and analysts, the Committee and others about investor information needs related to supply chain finance arrangements, or what we refer to in this paper as 'supplier finance arrangements' (see paragraphs 10-14 for further information about these terms). It also sets out staff recommendations for a narrow-scope standard-setting project to address those needs.

6. The paper contains:

   (a) summary of staff recommendations (paragraphs 8);

   (b) background information, including:

      (i) what is a supplier finance arrangement (paragraphs 10-14); and

      (ii) sources of feedback and input (paragraphs 15-16);

   (c) summary of feedback and input, including:

      (i) why information about supplier finance arrangements matter (paragraphs 17-21);

      (ii) existing IFRS requirements (paragraphs 22-23);

      (iii) the main matters identified (paragraphs 24-31); and

      (iv) the areas of possible standard-setting (paragraphs 32-45);

   (d) staff recommendations (paragraph 46-68); and

   (e) questions for the Board.

7. The paper has one appendix:

   (a) Appendix A - Agenda Decision published in December 2020.

Summary of staff recommendations

8. We recommend that the Board add a narrow-scope standard-setting project on supplier finance arrangements to the work plan. This project would:

   (a) explain the type of arrangements within its scope, rather than include specific definitions (see paragraphs 53-58 of this paper);

   (b) add qualitative and quantitative disclosure requirements to IAS 7 *Statement of Cash Flows* (see paragraphs 59-65 of this paper); and

   (c) add 'sign-posts' to existing disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* (see paragraphs 66-68 of this paper).

Background

9. As background information:

   (a) paragraphs 10-14 explain:

      (i) the term 'supply chain finance';

      (ii) what we mean by 'supplier finance'; and

      (iii) how supplier finance works.

   (b) paragraphs 15-16 outline the sources of feedback and input.

What is a supplier finance arrangement?

Supply chain finance

10. The term ‘supply chain finance’ refers to a broad range of financing arrangements related to an entity’s working capital. For example, the Global Supply Chain Finance Forum (GSCFF)[1] defines supply chain finance to include a variety of techniques, including financing for receivables (eg factoring arrangements), financing for inventories (eg pre-shipment financing) and financing for payables (eg payables finance arrangements). Many use ‘supply chain finance’ to describe only arrangements that finance payables (such as payables finance or reverse factoring arrangements). However, because the term can also refer to arrangements related to receivables and inventories (outside the scope of this paper), we have used the term ‘supplier finance’.

What do we mean by supplier finance?

11. The Committee’s Agenda Decision (see Appendix A) dealt with reverse factoring arrangements. The term ‘supplier finance’ used in this paper is intended to include all arrangements an entity enters into to fund payables to its suppliers, rather than for example only arrangements labelled as ‘reverse factoring arrangements’. In other words, this term would capture all arrangements that are economically similar to reverse factoring arrangements.

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[1] The Global Supply Chain Finance Forum was established in 2014 to develop, publish and champion a set of commonly agreed standard market definitions for Supply Chain Finance. Comprised of trade bodies BAFT (Bankers’ Association for Finance and Trade), Factors Chain International (FCI), the International Chamber of Commerce (ICC), the International Trade and Forfaiting Association (ITFA) and the Euro Banking Association (EBA) the industry consortium leverages its collective footprint to aid the target audience of supply chain finance in gaining clarity and consistency on the various terms and techniques used. For more information see http://supplychainfinanceforum.org.

How does supplier finance work?

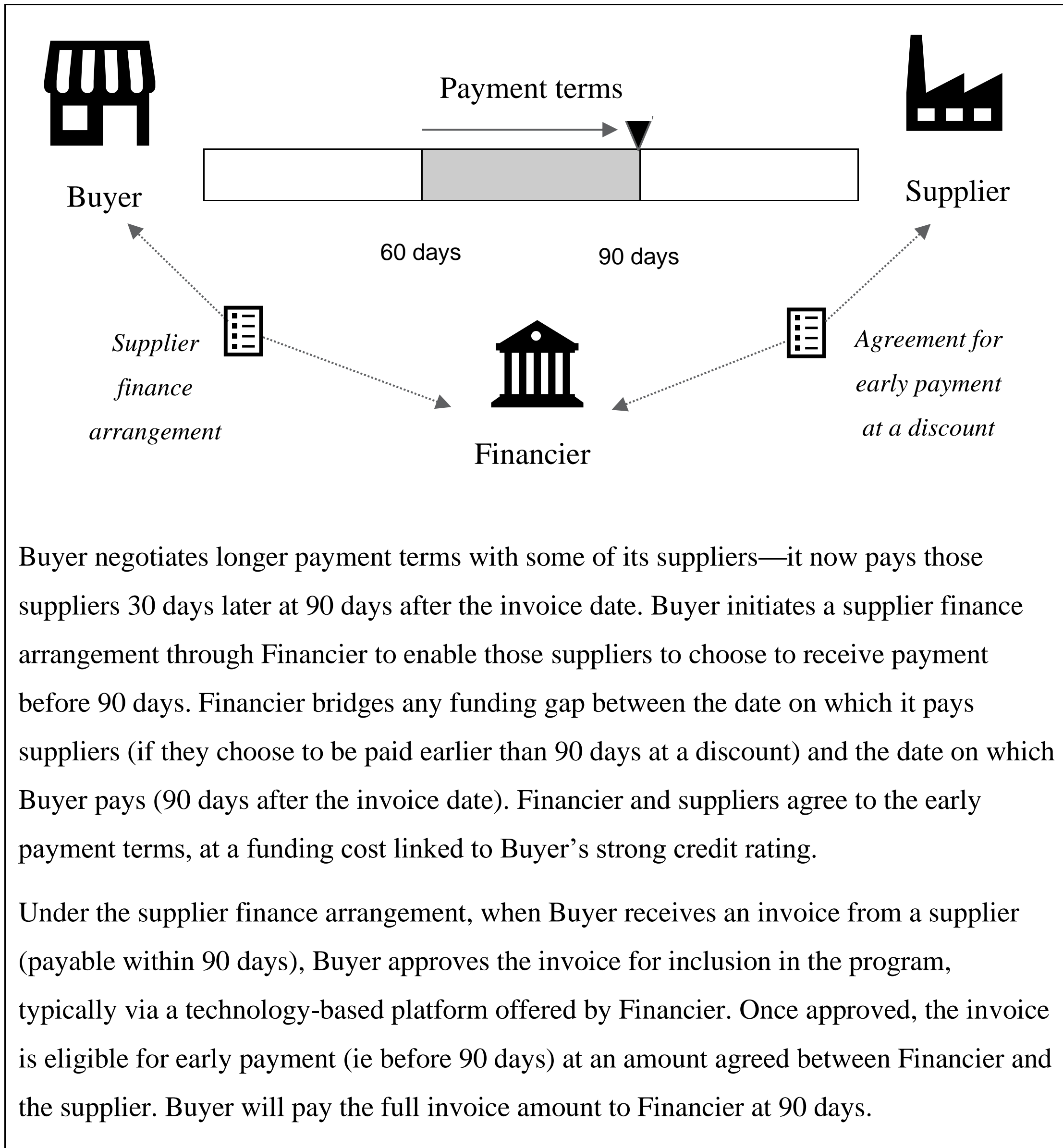
12. A buyer receives goods and services from suppliers and negotiates payment terms with those suppliers. The buyer initiates a supplier finance arrangement through a finance provider to enable its suppliers to receive payment from the finance provider before the buyer pays for the goods or services. The finance provider bridges any funding gap between the date on which suppliers receive payment for goods or services and the date on which the buyer pays for those goods or services.

13. A supplier finance arrangement can be structured in different ways. For example:

    (a) the arrangement can be one in which the buyer obtains no extension of credit from the finance provider, ie the buyer settles invoices that are part of the arrangement on the due date as negotiated with its suppliers. Suppliers (that are part of the arrangement) can choose to be paid earlier than the invoice due date by the finance provider, at a discount. The buyer may (or may not) have been able to negotiate extended payment terms with its suppliers as a consequence of the supplier finance arrangement being in place.

    (b) the arrangement can be one in which the buyer obtains extended credit from the finance provider, ie the buyer pays the finance provider at a date later than the invoice due date for an amount that is more than the invoice amount; the finance provider pays suppliers the amounts they are owed by the buyer on the invoice due date.

14. Illustration 1 sets out an example of a supplier finance arrangement.



Buyer negotiates longer payment terms with some of its suppliers—it now pays those suppliers 30 days later at 90 days after the invoice date. Buyer initiates a supplier finance arrangement through Financier to enable those suppliers to choose to receive payment before 90 days. Financier bridges any funding gap between the date on which it pays suppliers (if they choose to be paid earlier than 90 days at a discount) and the date on which Buyer pays (90 days after the invoice date). Financier and suppliers agree to the early payment terms, at a funding cost linked to Buyer's strong credit rating.

Under the supplier finance arrangement, when Buyer receives an invoice from a supplier (payable within 90 days), Buyer approves the invoice for inclusion in the program, typically via a technology-based platform offered by Financier. Once approved, the invoice is eligible for early payment (ie before 90 days) at an amount agreed between Financier and the supplier. Buyer will pay the full invoice amount to Financier at 90 days.

Illustration 1: An example of a supplier finance arrangement

Sources of feedback and input

15. During 2020 and 2021 to date, we received feedback and input on (a) investor information needs related to supplier finance arrangements, (b) how the arrangements work, (c) the prevalence of the arrangements throughout the world, and (d) the information currently available—and that could be made available by the finance provider—to entities that initiate these types of arrangements.

16. We received that feedback and input from the following stakeholders:

    (a) **Investors and analysts**: various meetings including with sell-side analysts, buy-side analysts, analysts at credit rating agencies and investment professional bodies at which we were informed of investor information needs.

    (b) **Financial institutions (that act as the finance provider in supplier finance arrangements), one banking association and one buyer that enters into supplier finance arrangements:** various meetings at which we were informed of how supplier finance arrangements work and the information to which the buyer in such arrangements would have legal access.

    (c) **Committee members**: discussions at the April, June and December 2020 Committee meetings.

    (d) **Respondents to the tentative agenda decision**: the Committee received 22 comment letters, many of which commented on whether there is a need for standard-setting and what any such project should address. Those comment letters included three letters from investor organisations.

Feedback and input

Why information about supplier finance arrangements matter

17. Supplier finance arrangements appear to be common in many jurisdictions throughout the world—respondents to the Committee's outreach on the topic indicated that they are common in Australia, Brazil, China, Malaysia, Singapore, South Africa, South Korea, Belgium, Denmark, France, Germany, the Netherlands, Spain, Switzerland and the UK. We have also been informed that the use of supplier finance arrangements has increased during the covid-19 pandemic.

18. Stakeholders want to better understand the use of supplier finance arrangements. For example, securities regulators in some jurisdictions have had a particular focus in recent years on the information being provided in financial statements about supplier finance arrangements. In some jurisdictions, including the UK and Australia, private commercial policy matters such as payment terms—in some cases related to supplier finance arrangements—are being examined by business associations, with a particular focus on fairness for small and medium-sized enterprises.

19. Supplier finance arrangements may also have a material effect on entities that initiate such arrangements, especially in situations in which:

    (a) the entity's payment terms with its suppliers have been extended (sometimes beyond what may be considered standard industry terms); or

    (b) facilities are withdrawn in times of stress, creating pressure on liquidity.

20. Without adequate information in entities' financial statements, investors and analysts have informed us that:

    (a) they find it difficult to compare financial statements of entities that use supplier finance arrangements and those that do not.

    (b) supplier finance arrangements can obscure the total amount of an entity's borrowings. This may cause:

        (i) investors to misallocate capital and misprice credit risk.

(ii) if borrowings are under-reported, inflated market equity valuations by equity investors.

(iii) leverage finance investors to be unaware of the additional source of liquidity risk, compounding the capital allocation and pricing challenges described in (i) and (ii) above.

(iv) finance providers to have an asymmetric information advantage versus debt capital market investors.

(c) supplier finance can also complicate the distinction between operating and financing cash flows, affecting analysis of the entity's cash conversion cycle and associated financial ratios.

21. For example, in their comment letters on the tentative agenda decision, the European Leveraged Finance Association and Fermat Capital Management, LLC observed respectively:

> Our members find that such arrangements are frequently not disclosed in annual and quarterly reports, resulting in under-reported financial debt. This is particularly problematic for leveraged finance investors making their investment decisions based on reported financial debt, as they would be unaware of the additional leverage funded through such arrangements. Therefore, when such arrangements are not disclosed, investors may misallocate capital and misprice credit risk. This is also problematic for equity investors as under reported financial debt might translate into inflated market equity valuations. Default risk is a key consideration for leveraged finance investors and the risk can be exacerbated by these arrangements, which are generally short-term in nature and can be pulled at short notice. When banks pull out of these lines, the resulting working capital shock can potentially trigger a liquidity crisis that could lead to the issuer's default, without any warning sign for investors. When these arrangements are not disclosed, leverage finance investors are unaware of this additional source

of default risk, compounding the capital allocation and pricing challenge described in the previous point.

As investors we share the concerns outlined in the submission, namely, that without adequate disclosures: a) it is difficult to compare financial statements of companies that use and do not use reverse factoring, b) reverse factoring can obscure "debt-like liabilities" and, c) reverse factoring can complicate default risk assessments by obfuscating the important distinction between operating and financing cashflows. As investors, we welcome appropriate and informative disclosures in financial statements, however, we do not believe current disclosures are sufficient.

Existing IFRS requirements

22. The Committee published the Agenda Decision *Supply Chain Financing Arrangements—Reverse Factoring* in December 2020 (see Appendix A). Although existing IFRS Standards do not explicitly refer to supply chain finance, supplier finance or reverse factoring arrangements, the Agenda Decision explains the existing IFRS requirements applicable for an entity that has entered into a reverse factoring arrangement. The Agenda Decision covers requirements that deal with presentation of the entity's liabilities that are part of the arrangement in the statement of financial position, presentation of cash flows in the statement of cash flows, derecognition requirements and disclosure about financing activities, liquidity risks and risk management.

23. As mentioned above, we received input on the possible need for standard-setting related to supplier finance arrangements as part of the feedback and input we received on the Committee's project. The next section of the paper outlines the main matters identified.

Main matters identified

24. This section of the paper summarises the input received on:

    (a) the information entities currently provide about supplier finance arrangements (paragraphs 25-28); and

    (b) investor information needs (paragraphs 29-31).

Information entities currently provide

25. The input received suggests that application of existing IFRS requirements in relation to supplier finance arrangements is insufficient to address investor information needs (see, for example, references to comments in the submission (paragraph 3 of this paper), in investor comment letters (paragraph 21 of this paper) and in an article recently published by Standard & Poor's[2]).

26. The UK Financial Reporting Council also comments:

> After the collapse of a significant UK construction business in 2018, the reporting of supply chain financing arrangements has received much attention in the UK, and we are very clear that addressing any reporting weaknesses in this area is in the public interest. Our research suggests that reverse factoring is a significant funding alternative for certain industry sectors. Nevertheless, we find a gap between the apparent prevalence of these transactions and the information disclosed in financial statements. In September 2019, the Financial Reporting Lab of the FRC issued a report on *Disclosures on the sources and uses of cash*[3], which also addressed reverse factoring. Our analysis showed that good reporting in this area is rare.

[2] Supply Chain Finance: How To Remedy Flawed Financial Reporting In that article, S&P concludes that, for entities 'using supply chain finance to delay the time taken to pay invoices, current accounting rules and disclosures are not fit for purpose'.

[3] Disclosures-on-the-sources-and-uses-of-cash-Final.pdf (frc.org.uk)

27. In addition to the input received, we used the financial search engine, AlphaSense, to assess the amount and nature of information that entities provide about supplier finance arrangements. We performed the search twice—in March 2020 and again in April 2021. The search considered entities' most recent interim or annual financial statements, as well as for the 2021 search, event transcripts, press releases, and ESG reports. The search was limited to documents in English. We searched for 'supply chain finance', 'supply chain financing', 'reverse factoring', 'supplier finance', 'supplier financing', 'structured payable transaction', 'structured payable' as well as 'reverse factoring', 'dynamic discounting' and 'supplier inventory financing'. Our search in 2020 and 2021 identified a total of 219 and 291 documents that contain these phrases, respectively. From a review of extracts from these publicly-available documents, there are a wide range of disclose practices—from those that mention only that an arrangement exists to those that provide detailed qualitative and quantitative information.

28. We have been informed that entities now provide more information about supplier finance arrangements than in the past, and we would also hope that the Agenda Decision published in December 2020 will have a positive influence on the information provided in financial statements about those arrangements. Nonetheless, in the absence of standard-setting, we would expect the information entities provide to continue to be very varied in detail and quality.

Investor information needs

29. The input received form investors and analysts confirms that information about supplier finance arrangements is important to investors' decision-making. Investors need information that helps them to (a) assess the effect of supplier finance arrangements on an entity's financial position and cash flows, and (b) compare those effects across entities.

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

(a) how supplier finance arrangements affect an entity's working capital management, both in terms of the total amount of trade payables subject to those arrangements and the effect on key financial ratios, such as free cash flows or days payable.

(b) how an entity's financial position would change if the supplier finance arrangements were no longer available to the entity. Said differently, investors are interested in understanding the extent to which supplier finance arrangements affect the entity's liquidity.

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

(a) the amounts payable subject to supplier finance arrangements, including the amounts payable to the finance provider because the supplier of the goods or services has already been paid by that finance provider. This information would help an investor determine an entity's total debt.

(b) where, and how, an entity has presented its liabilities (that are part of supplier finance arrangements) in the statements of financial position and cash flows. For example, whether and why these liabilities are classified as trade payables or loans payable.

(c) the nature of supplier finance arrangements, including any payment term extensions, the effect of the arrangement on the entity's days payable and the duration of that effect. For example, whether improvements in days payable is one-off or expected to occur again in future periods.

(d) the risks to which the entity is exposed. For example, liquidity risks arising from supplier finance arrangements and how the entity manages those risks.

The areas of possible standard-setting

32. From the information needs in paragraphs 29-31 above, we identified three areas of financial reporting for which the input indicates a possible need for standard setting:

    (a) presentation in the statement of financial position (paragraphs 34-36);

    (b) information about an entity's cash flows (paragraphs 37-39); and

    (c) disclosure (paragraphs 40-42).

33. Some stakeholders also noted caution in considering whether to add a standard-setting project (see paragraphs 43-45).

Presentation in the Statement of Financial Position

34. The Agenda Decision (see Appendix A) explains the existing IFRS requirements an entity applies to determine whether to present liabilities that are part of a reverse factoring arrangement (a) within trade or other payables, (b) within other financial liabilities, or (iii) as a line item separate from other items in its statement of financial position.

35. Some suggest that it might be beneficial to add further requirements on the nature of liabilities that arise from supplier finance arrangements to help determine whether their nature is similar to, or dissimilar from, that of a trade payable or borrowings. The objective would be to potentially achieve greater consistency in distinguishing between trade payables (part of an entity's working capital) and borrowings.

36. We heard a variety of views about:

    (a) *when* the liability might no longer be classified as trade or other payables, for example, when:

        (i) the entity—as the buyer—approves the invoice for inclusion in the supplier finance arrangement. Some think the nature of the liability changes at that point, regardless of whether any

additional security is provided or whether the terms of those liabilities differ from the terms of other trade payables.

(ii) the entity approves the invoice for inclusion in the supplier finance arrangement *and* the payment terms are extended beyond standard industry payment terms.

(iii) the finance provider pays the supplier, ie the entity owes the finance provider instead of the supplier of the goods or services.

(iv) the derecognition requirements in IFRS 9 *Financial Instruments* are met. The new financial liability is a loan payable to the finance provider; it is no longer a trade payable to the supplier of the goods or services.

(v) the contract between the entity and the finance provider creates secured legal asset encumbrances for the entity.

(vi) the entity is involved in defining the terms of the agreements between the finance provider and the entity's suppliers.

(b) *how much* of the liability represents a loan payable, for example:

(i) the full amount; or

(ii) only the part that relates to the period of the payment terms that is longer than standard industry terms. For example, an entity owes CU100, payable 180 days after the invoice date. The standard industry payment term is 60 days after the invoice date. In that case, the loan payable would amount to CU67 (CU100 × (180 – 60) ÷ 180) and the trade payable CU33. Some suggest this split because, in their view, classifying the entire payable as a loan payable would overstate the entity's borrowings and, consequently, potentially understate the entity's operating cash outflows.

Information about an entity's cash flows

37. Investors highlight the importance of understanding the cash flow effects of, and obtaining cash flow information about, supplier finance arrangements. The Agenda Decision (see Appendix A) explains the existing IFRS requirements an entity applies in presenting cash flows in its statement of cash flows.

38. We understand—based on the feedback and input received—that, having considered the terms of a particular supplier finance arrangement, an entity determines either:

    (a) there are no cash flows at the date the finance provider pays the entity's supplier. When the entity pays the finance provider on the same or a later date, it presents the cash outflow as part of operating activities;

    (b) there are no cash flows at the date the finance provider pays the entity's supplier and it discloses a non-cash transaction applying paragraph 43 of IAS 7. When the entity pays the finance provider on the same or a later date, it presents the cash outflow as part of financing activities; or

    (c) there is a financing cash inflow and an operating cash outflow at the date the finance provider pays the entity's supplier. When the entity pays the finance provider on the same or a later date, it presents the cash outflow as part of financing activities.

39. Some suggest it might be beneficial to add requirements to IAS 7 to clarify how to identify when a cash flow has occurred (for example, to help determine when the finance provider acts as a paying agent on behalf of the entity). Some have also said, in their view, it could be misleading if an entity never presents an operating cash outflow for goods and services it acquires—this would be the outcome if the supplier finance arrangement creates a non-cash financing transaction as outlined in paragraph 38(b) above.

Disclosure

40. The Agenda Decision highlights existing disclosure requirements in IAS 1 *Presentation of Financial Statements*, IAS 7 and IFRS 7 applicable in the context of reverse factoring arrangements.

41. The input received indicates that entities often disclose little information about the existence and effects of supplier finance arrangements. Entities presenting liabilities (that are part of these arrangements) as other financial liabilities disclose information about the arrangements more frequently than those presenting liabilities as trade and other payables. However, because of the limited information provided in financial statements, some suggest standard-setting is needed to add disclosure requirements that explicitly deal with supplier finance arrangements.

42. Stakeholders provided several examples of possible disclosure requirements including, for example:

    (a) a statement confirming an entity's use of supplier finance arrangements.

    (b) the terms and conditions of supplier finance arrangements. For example, any payment term extensions, whether the arrangement is secured by the entity's assets, and qualitative information about the entity's involvement in the establishment of the supplier finance arrangement.

    (c) the extent to which amounts are owed to finance providers (and thus not the suppliers of the goods or services), regardless of the line item within which the amounts are presented.

    (d) a description of the entity's policy in presenting the arrangement and the judgements made in applying the policy. This should include the carrying amount of the liabilities that are part of the arrangement and the line items in which those liabilities are presented.

    (e) how the entity manages and monitors these arrangements, including any possible effects on the viability of the business. This should include

changes to the arrangement in the reporting period (or subsequently) that would affect presentation or result in a change in liquidity risk.

(f) a maturity analysis, applying paragraphs 39(a) and B11 of IFRS 7, separately for liabilities that are part of the arrangement.

Caution in adding a standard-setting project

43. Although many stakeholders—including all investors and analysts—that provided input indicated support for a narrow-scope standard-setting project, not all stakeholders we consulted supported such a project.

44. We received words of caution that:

(a) supplier finance arrangements represent one type of financing—there are many others—which possibly reduces the need for specific disclosure requirements, which if added could cause 'disclosure overload' for preparers. In addition, some think the existing disclosure requirements within IFRS Standards are sufficient to require entities to provide useful information about supplier finance arrangements.

(b) it could be difficult to define the arrangements within the scope of any new disclosure requirements. Questions might also arise as to whether supply chain finance arrangements (other than supplier finance arrangements)—for example, factoring of receivables—should also be included within the scope of any standard-setting project.

45. Some also said it is important that any narrow-scope standard-setting project:

(a) align with other projects on the Board's work plan dealing with presentation and disclosure.

(b) achieve a balance between providing a clear principle (or objective) and prescriptive requirements.

Staff recommendations

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

    (a) Does the matter have widespread effect and has, or is expected to have, a material effect on those affected? In the light of the information received explaining why information about supplier finance arrangements matter (see paragraphs 17-21 of this 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? (See paragraphs 47-48 of this paper.)

    (c) Can the matter be resolved effectively within the confines of existing Standards and the *Conceptual Framework* and is it sufficiently narrow in scope? (See paragraphs 49-68 of this paper.)

The need for standard-setting

47. Existing IFRS Standards include requirements that address some investor information needs with respect to supplier finance arrangements (see the Agenda Decision in Appendix A). In particular, to the extent relevant to an understanding of its financial statements, an entity:

    (a) presents separately liabilities that are part of supplier finance arrangements;

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

    (c) provides information about its exposure to liquidity risk arising from supplier finance arrangements.

48. However, the information an entity provides applying existing requirements would not, in our view, meet *all* investor needs. In particular, investors may be unable to

obtain the information they need about the terms of supplier finance arrangements and how the arrangements affect the entity's working capital and cash flows. 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 or what the effects of the arrangements are on the financial statements. Accordingly, in paragraphs 59-68, we discuss additional disclosure requirements that, in our view, would help investors obtain information that would be useful for their analyses.

A narrow-scope standard-setting project

49. Based on our analysis, we conclude that the Board could address investor information needs with respect to supplier finance arrangements (see paragraph 31) within a narrow-scope standard-setting project focussed on disclosure. We therefore recommend that the Board add a narrow-scope standard-setting project on supplier finance arrangements to the work plan.

50. The narrow-scope project would:

    (a) explain the type of arrangements within its scope, rather than developing detailed definitions (**Recommendation 1**) (see paragraphs 53-58);

    (b) add new disclosure requirements to IAS 7 (**Recommendation 2**) (see paragraphs 59-65); and

    (c) add 'sign-posts' to existing disclosure requirements in IFRS 7 (**Recommendation 3**) (see paragraphs 66-68).

51. We have considered standard-setting only with respect to possible disclosure requirements, and not the following aspects of accounting for supplier finance arrangements for the reasons explained:

(a) **The presentation of liabilities that are part of supplier finance arrangements**: IAS 1 specifies presentation requirements for assets and liabilities. Any project to address the presentation of liabilities would need to consider not only liabilities that are part of supplier finance arrangements but, at least, all financial liabilities (if not all liabilities). Input indicates the likely difficulty in developing requirements in this respect—stakeholders provided many different views on the nature of liabilities that are part of supplier finance arrangements (see paragraph 36). We also note that, as part of its project on *Primary Financial Statements*, the Board has proposed principles for aggregation and disaggregation of items—those proposals, if finalised, would be expected to be helpful with respect to presenting liabilities that are part of supplier finance arrangements. Indeed, the Board recently discussed these liabilities in redeliberating the disaggregation principles within the *Primary Financial Statements* project, and we understand the Board will further consider supplier finance arrangements at future discussions of that project.

(b) **The presentation of cash flows related to supplier finance arrangements**: IAS 7 specifies requirements for the presentation of cash flows in the statement of cash flows. If the Board were to undertake a project to address when a cash flow has occurred and the presentation of cash flows, such a project would need to have a wide scope that would consider *all* cash flows, not only cash flows related to supplier finance arrangements. We note that the Board's *Third Agenda Consultation* includes as a potential financial reporting issue to be addressed in a Board project the statement of cash flows and related matters.

52. We also note that at its October 2020 meeting, the Financial Accounting Standards Board (FASB) decided to add a project to its technical agenda to develop disclosure requirements related to supplier finance programs involving trade payables. Details about the FASB's project is available here.

Recommendation 1

53. Limiting the project to any one type of arrangement, such as reverse factoring or payables finance arrangements, could reduce the relevance of the amendments because supply chain finance and supplier finance are not static concepts. There is an evolving set of practices and arrangements using or combining a variety of techniques. The techniques are often used in combination with each other and with other financial and physical supply chain services. We have been informed that the use of supply chain finance has increased in recent years and is expected to continue. The 2020 McKinsey Global Payments Report states[4]:

> Room for growth in supply-chain finance? Conceptually speaking, the potential market for supply-chain finance encompasses every invoice and receipt issued by corporates—up to $17 trillion globally…In practice, however, there is a large global gap in trade finance, estimated to be $1.5 trillion, rising to $2.5 trillion by 2025. This estimate was forecast by the World Economic Forum before the start of the COVID-19 pandemic.

54. For these reasons, we recommend that the narrow-scope project include:

    (a) *liabilities* that are part of *all* supplier finance arrangements; and

    (b) an *explanation* of the type of arrangements within its scope, rather than detailed definitions.

Liabilities that are part of supplier finance arrangements

55. We recommend that the narrow-scope project include all supplier finance arrangements, but not go beyond supplier finance. We are therefore also recommending that the Board not include within the scope of this project arrangements an entity uses to fund either receivables from customers (for example,

[4] Supply-chain finance: A case of convergent evolution?

factoring arrangements) or inventories (for example, pre-shipment finance arrangements).

56. The input and feedback received revealed no significant investor information concerns about receivables or inventories financing arrangements. Although some investors mentioned a desire for improved information about factoring arrangements, some also said they already obtain information about those arrangements and noted that the risks that arise from such arrangements are different from those that arise from supplier finance arrangements. Widening the scope of the project to include factoring arrangements might result in delaying what investors and analysts consulted viewed as much needed improvements to the information entities provide about supplier finance arrangements.

57. In addition, IFRS 7 already includes requirements applicable to some types of receivables financing arrangements—paragraphs 42A-42H of IFRS 7 contain disclosure requirements for transfers of financial assets that are not derecognised and for any continuing involvement in a transferred asset. We also think, because any liabilities that arise from these arrangements relate to an entity’s assets (receivables or inventories), investors can more easily identify whether those liabilities are borrowings of the entity than is the case for supplier finance arrangements. Consequently, they can more easily assess the effect of those arrangements on an entity’s total debt and cash flows.

An explanation of the type of arrangements

58. We recommend that the narrow-scope project explain the type of arrangements to be included within its scope, rather than include detailed definitions. A detailed definition—even if perfectly crafted at the time of developing the requirements—risks becoming outdated as new techniques and arrangements develop over time. We recommend a combination of two ways to explain the type of arrangements:

    (a) specifying characteristics of the arrangements. As an example, a characteristic we would suggest is an arrangement whereby the entity involves a finance provider to fund any period of time between when the

entity's suppliers are paid for goods or services the entity receives and when the entity pays for those goods or services.

(b) listing examples of the arrangements; for example, specifying as examples reverse factoring, payables finance and 'other similar' arrangements.

Recommendation 2

New disclosure objectives and disclosure requirements

59. Paragraphs 7.4 and 7.5 of the *Conceptual Framework* states:

> 7.4 To facilitate effective communication of information in financial statements, when developing presentation and disclosure requirements in Standards a balance is needed between:
>
> (a) giving entities the flexibility to provide relevant information that faithfully represents the entity's assets, liabilities, equity, income and expenses; and
>
> (b) requiring information that is comparable, both from period to period for a reporting entity and in a single reporting period across entities.
>
> 7.5 Including presentation and disclosure objectives in Standards supports effective communication in financial statements because such objectives help entities to identify useful information and to decide how to communicate that information in the most effective manner.

60. Considering the aforementioned guidelines, Table 1 explains our recommendation to add new disclosure requirements[5].

61. The additional disclosure requirements would set out:

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[5] In March 2021, the Board published the Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach*. The Exposure Draft sets out a proposed new approach to developing and drafting disclosure requirements in IFRS Standards. We also considered these proposals when developing Recommendation 2.

(a) **an overall disclosure objective and specific objectives**: These objectives 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 or requirements.

(b) **disclosure requirements:** required to meet each specific disclosure objective.

62. An entity would aggregate the information for different arrangements only when the terms are similar.

Overall disclosure objective	To help users of financial statements understand the nature, timing, and uncertainty of cash flows arising from supplier finance arrangements.

Specific disclosure objective	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.
Disclosure requirements	Rationale (cost vs benefit)
• As at the opening and closing reporting date: i) the aggregate amount of payables that are part of the arrangement; ii) the aggregate amount of the payables disclosed under i) for which suppliers have already received payment from the finance provider; iii) the range of payment terms, expressed in time, of payables disclosed under i); and iv) the range of payment terms, expressed in time, of trade payables that do not form part of the arrangement.	• Investors would be able to use this information to help determine—within their own models—the entity's total debt and the effect of these arrangements on the operating cash conversion cycle. For example, the information would help investors estimate the cash flow effects of initiating, or increasing the use of, supplier finance arrangements in situations in which the entity has been able to extend the payment terms of payables that are part of the arrangement. This information is important to help assess, for example, the extent to which operating cash flows arise from the use of supplier finance arrangements. • We expect the information in i), iii) and iv) to be available to entities. We understand that entities often do not obtain the information in ii). However, input received from financial institutions that act as finance providers indicates that, should entities need it, finance providers would be able to provide the information in ii)—on an aggregated and anonymised basis[6]—to entities. Disclosing this information is likely to result in additional costs for entities; however, we would not expect those costs to be excessive because most of the information is already available to entities and that information is factual as opposed to requiring judgement. In the light of the importance of this information for investors' decision-making (see paragraphs 29-31), we conclude that the expected benefits would outweigh these costs.

[6] Depending on the terms of the arrangement, the terms of the agreements between the finance provider and suppliers, and the legislation applicable to those contracts, there may be legal restrictions preventing the finance provider from providing the information in ii) for individual suppliers. However, those restrictions are not expected to prevent the finance provider from providing the information to the buyer on an aggregated and anonymised basis.

Specific disclosure objective	To provide *qualitative* information to help users of financial statements understand the risks that arise from supplier finance arrangements.
Disclosure requirements	Rationale (cost vs benefit)
• The key terms and conditions of the arrangement (including, for example, any extended payment terms and any security or guarantees provided to the finance provider).	• The information would help investors understand the context for the quantitative information provided about the arrangement and, together with that quantitative information, the risks that arise from the arrangement. • We expect entities to have access to this information without incurring undue costs.

Table 1: Recommendation to add new disclosure requirements

63. Illustration 3 provides illustrative *quantitative* information that Buyer would provide based on our recommendations. Buyer is as per the example in illustration 1 (see paragraph 14 of this paper).

Buyer - Annual financial statements for the reporting period ended 31 December 20X1

Supplier finance arrangement

…

	At 31 December 20X0	**At 31 December 20X1**
(i) Aggregate amount of payables that form part of the arrangement	CU1,000	CU1,500
(ii) Aggregate amount of payables in (i) for which suppliers have been paid	CU800	CU1,050
(iii) Payment terms of payables that form part of the arrangement	90 days after invoice date	90 days after invoice date
(iv) Range of payment terms of trade payables that do not form part of the arrangement	45- 60 days after invoice date	45-75 days after invoice date

Illustration 3: Illustrative quantitative information

Disclosure requirements considered but rejected

64. As summarised earlier in the paper (see paragraph 42), we received suggestions for other possible new disclosure requirements. Our approach was to identify the information that, based on investor input, we viewed as providing the greatest benefit to investors but without asking entities to provide an excessive amount of information.

Said differently, we aimed to identify the information for which there would be greatest 'bang for your buck'.

65. For example, we decided not to recommend adding a requirement to disclose:

   (a) an entity's reasons for entering the arrangement. From input and feedback received, we would expect entities to provide uniform—and possibly boilerplate—information to meet this requirement.

   (b) the extent to which an entity is involved in setting up the arrangement and designing the early-payment terms with suppliers. Again, we were unsure that investors would obtain meaningful information from such a requirement. We viewed information about the contractual terms and conditions of the arrangement—and thus about the entity's rights and obligations arising from the arrangement—as providing more useful information than this requirement.

Recommendation 3

66. The Agenda Decision (see Appendix A) notes that reverse factoring arrangements often give rise to liquidity risk because (a) the entity has concentrated a portion of its liabilities with one finance provider rather than a diverse group of suppliers; and (b) the entity may have become reliant on extended payment terms or the entity's supplier may have become accustomed to, or reliant on, earlier payment under the arrangement. It also highlights the liquidity risk disclosure requirements in paragraphs 31-35, 39 and B10-B11 of IFRS 7.

67. Understanding the liquidity risks that arise from supplier finance arrangements is important for investors—supplier finance arrangements can often legally be withdrawn by the finance provider at short notice. With that said, the liquidity risk disclosure requirements in IFRS 7 are, in our view, already comprehensive and we see no need to add to them.

68. We recommend adding 'sign-posts' to those liquidity risk disclosure requirements—for example to paragraph B11F (dealing with factors an entity might consider in explaining how it manages liquidity risk) and paragraph IG18 (dealing with examples

of concentrations of risk). The 'sign-post' would be in the form of explicitly referring to the liquidity risks that arise from supplier finance arrangements as examples within the requirements in IFRS 7.

Questions for the Board

Question 1
The staff recommend adding a narrow-scope standard-setting project to the Board's work plan in relation to supplier finance arrangements. Does the Board agree with our recommendation?

Question 2
If the Board votes to add a narrow-scope standard-setting project, the staff recommend that the project: a. explain the type of arrangements within its scope, rather than include detailed definitions (as explained in paragraphs 53-58 of this paper) (**Recommendation 1**); b. add new disclosure requirements to IAS 7 (as set out in Table 1 after paragraph 62 of this paper) (**Recommendation 2**); and c. add 'sign-posts' to existing disclosure requirements in IFRS 7 (as explained in paragraphs 66-68 of this paper). (**Recommendation 3**) Does the Board agree with our recommendations?

Appendix A—Agenda decision

A1. The Agenda Decision *Supply Chain Financing Arrangements—Reverse Factoring*, as included in **IFRIC Update December 2020**:

Supply Chain Financing Arrangements—Reverse Factoring—Agenda Paper 4

The Committee received a request about reverse factoring arrangements. Specifically, the request asked:

a. how an entity 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.

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.

Presentation in the statement of financial position

IAS 1 *Presentation of Financial Statements* specifies how an entity is required to present its liabilities in the statement of financial position.

Paragraph 54 of IAS 1 requires an entity to present 'trade and other payables' separately from other financial liabilities. 'Trade and other payables' are sufficiently different in nature or function from other financial liabilities to warrant separate presentation (paragraph 57 of IAS 1). Paragraph 55 of IAS 1 requires an entity to present additional line items (including by disaggregating the line items listed in paragraph 54) when such presentation is relevant to an understanding of the entity's financial position. Consequently, an entity is required to determine whether to present liabilities that are part of a reverse factoring arrangement:

a. within trade and other payables;

b. within other financial liabilities; or

c. as a line item separate from other items in its statement of financial position.

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'. 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 it:

a. represents a liability to pay for goods or services;

b. is invoiced or formally agreed with the supplier; and

c. 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 liabilities that are part of a reverse factoring arrangement:

a. as part of 'trade and other payables' only when those liabilities have a similar nature and function to trade payables—for example, when those liabilities are part of the working capital used in the entity's normal operating cycle.

b. separately when the size, nature or function of those liabilities makes separate presentation relevant to an understanding of the entity's financial position. In assessing whether it is required to present such liabilities separately (including whether to disaggregate trade and other payables), an entity considers the amounts, nature and timing of those liabilities (paragraphs 55 and 58 of IAS 1).

The Committee observed that an entity assessing whether to present liabilities that are part of a reverse factoring arrangement separately might consider factors including, for example:

a. whether additional security is provided as part of the arrangement that would not be provided without the arrangement.

b. the extent to which the terms of liabilities that are part of the arrangement differ from the terms of the entity's trade payables that are not part of the arrangement.

Derecognition of a financial liability

An entity assesses whether and when to derecognise a liability that is (or becomes) part of a reverse factoring arrangement applying the derecognition requirements in IFRS 9 *Financial Instruments*.

An entity that derecognises a trade payable to a supplier and recognises a new financial liability to a financial institution applies IAS 1 in determining how to present that new liability in its statement of financial position (see 'Presentation in the statement of financial position').

Presentation in the statement of cash flows

Paragraph 6 of 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 how to classify cash flows under the arrangement, typically as cash flows from operating activities or cash flows from financing activities. The Committee observed that an entity's assessment of the nature of the liabilities that are part of the arrangement may help in determining whether the related cash flows arise from operating or financing activities. For example, if the entity considers the related liability to be a trade or other 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 the 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, if a cash inflow and cash outflow occur for an entity when an invoice is factored as part of a reverse factoring arrangement, the entity presents those cash flows in its statement of cash flows. If no cash inflow or cash outflow occurs for an entity in a financing transaction, the entity discloses the transaction elsewhere in the financial statements in a way that provides all the relevant information about the financing activity (paragraph 43 of IAS 7).

Notes to the financial statements

Paragraph 31 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to provide information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed. 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'. The Committee observed that reverse factoring arrangements often give rise to liquidity risk 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. If the entity were to encounter any difficulty in meeting its obligations, such a concentration would increase the risk that the entity might have to pay a significant amount, at one time, to one counterparty.

b. the entity may have become reliant on extended payment terms or the entity's supplier may have become accustomed to, or reliant on, earlier payment under the reverse factoring arrangement. If the financial institution were to withdraw the reverse factoring arrangement, that withdrawal could affect the entity's ability to settle liabilities when they are due, particularly if the entity were already in financial distress.

Paragraphs 33–35 of IFRS 7 require an entity to disclose how exposures to risk arising from financial instruments, including liquidity risk, arise; the entity's objectives, policies and processes for managing the risk; summary quantitative data about the entity's exposure to liquidity risk at the end of the reporting period (including further information if this data is unrepresentative of the entity's exposure to liquidity risk during the 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 whether to provide additional disclosures in the notes about the effect of reverse factoring arrangements on its financial position, financial performance and cash flows. The Committee observed that:

a. assessing how to present liabilities and cash flows related to reverse factoring arrangements may involve judgement. An entity discloses the judgements that management has made in this respect if they are among the judgements 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 those financial statements (paragraph 112 of IAS 1).

The Committee noted that making materiality judgements involves both quantitative and qualitative considerations.

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 noted 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.

The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine the presentation of liabilities that are part of reverse factoring arrangements, the presentation of the related cash flows, and the information to disclose in the notes about, for example, liquidity risks that arise in such arrangements. Consequently, the Committee decided not to add a standard-setting project on these matters to the work plan.