# Staff paper

Agenda reference: 12D

## IASB® meeting

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| Date | **November 2022** |
| Project | **Supplier Finance Arrangements** |
| Topic | **Feedback Analysis—Scope** |
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# Introduction

## Purpose of the paper

1. As discussed in Agenda Paper 12B for this meeting, this paper sets out our analysis and recommendations having considered comments received on the scope of the proposals in the Exposure Draft *Supplier Finance Arrangements*.

## Structure of the paper

2. This paper includes:

   (a) summary of staff recommendations;

   (b) background;

   (c) staff analysis and recommendations; and

   (d) question for the IASB (included after paragraph 27).

# Summary of staff recommendations

3. We recommend that the IASB:

   (a) make no change in response to suggestions to add characteristics;

   (b) make no change to further define or describe 'finance providers';

   (c) make no change to the scope related to suppliers financing their receivables;

   (d) revise the scope to specify that a supplier finance arrangement (SFA) is characterised by the entity 'agreeing to pay according to the terms and conditions of the arrangement' rather than 'agreeing to pay the finance providers';

(e) make no change to introduce scope restrictions based on:

(i) particular effects—or degrees of effect—of an arrangement as determined by the entity; or

(ii) application of the derecognition requirements in IFRS 9 *Financial Instruments*; and

(f) make no change to add explicit scope exclusions for arrangements involving particular types of payment instruments—and consider in drafting whether to add examples to the scope paragraph to illustrate the types of payment arrangements or instruments that are outside the scope of the disclosure requirements.

## Background

4. The proposed description of SFAs in the Exposure Draft says:

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

5. In summary, and as further explained in paragraphs BC5–BC11 of the Basis for Conclusions on the Exposure Draft, the International Accounting Standards Board (IASB) developed the description to:

(a) capture all SFAs with these characteristics, irrespective of the reason an entity entered into the arrangement or where and how it presents and classifies the related liabilities and cash flows in its statements of financial position and cash flows;

(b) not become outdated as new practices and arrangements evolve and develop;

(c) capture the characteristics of the SFAs that give rise to particular investor information needs (as explained in paragraphs 10–14 of Agenda Paper 12C for this meeting); and

(d) exclude arrangements that finance receivables or inventory.

## Summary of feedback[1]

6. Many respondents agreed with the IASB's approach for describing SFAs and with the proposed description itself. Some respondents suggested changes to the proposed description. We analyse the main suggested changes as follows:

   (a) adding characteristics;

   (b) clarifying the term 'finance providers';

   (c) clarifying the phrases 'finance providers offering to pay amounts an entity owes its suppliers' and 'the entity agreeing to pay the finance providers';

   (d) restricting the scope; and

   (e) other comments.

# Staff analysis and recommendations

## Adding characteristics

### *Respondents' feedback*

7. A few respondents suggested adding particular characteristics to the proposed description of SFAs, including that:

   (a) the entity proactively participates in the establishment or design of the arrangement; and

   (b) the entity confirms to the finance provider that a supplier invoice is valid or the entity issues an undertaking to pay an amount in favour of the finance providers. For example, in relation to disclosure requirements about supplier finance program obligations issued by the Financial Accounting Standards Board (FASB) in September 2022, the FASB includes as a characteristic of a supplier finance program that 'the entity confirms supplier invoices as valid to the finance provider or intermediary under the agreement'.

### *Staff analysis and recommendations*

#### *Entity's proactive participation in establishing the arrangement*

8. A few investors said they are interested in information about an entity's role and degree of involvement in setting up an arrangement; however, none suggested revising the description of SFAs to add as a

[1] Agenda Paper 12B for the July 2022 IASB meeting summarised respondents' feedback on the scope of the proposals in the Exposure Draft.

characteristic an entity's proactive participation in establishing the arrangement. We think adding such a characteristic would potentially restrict the scope—and, therefore, the disclosures about SFAs—to an extent that it would limit the usefulness of the information provided by applying the new requirements. Therefore, we recommend no change to the scope on this point.

***Confirmation that the payable is valid***

9. An entity's confirmation to the finance provider that a supplier invoice is valid is a contractual term agreed to by the parties to the SFA; there may be other terms—or controls—in place to verify amounts or specify actions of the parties. In our view, it is unnecessary for the description of SFAs to include those terms; by including them, there is a risk of inadvertently excluding arrangements from the scope—because of the way the parties to the arrangement structure their terms and operational procedures—that would otherwise be included based on their characteristics. Therefore, we recommend no change to the scope on this point.

## Clarifying the term 'finance providers'

### *Respondents' feedback*

10. A few respondents suggested clarifying the term 'finance providers' by:

    (a) clarifying whether it refers only to financial institutions or includes any type of entity or natural person; and

    (b) expanding it to include an intermediary.

### *Staff analysis and recommendations*

11. In developing the proposed scope, the IASB was aware that supplier finance practices and arrangements may evolve over time. For this reason, the IASB avoided being overly prescriptive in describing SFAs—or the term 'finance providers'.

12. In our view, the term 'finance providers' can be understood in the context of the description of an SFA: they are the parties 'offering to pay amounts an entity owes its suppliers'. The description does not limit 'finance providers' to a particular type of counterparty. By trying to be more specific about 'finance providers', there is a risk of inadvertently excluding arrangements from the scope that would otherwise be included based on their characteristics.

13. Therefore, we recommend no change to the scope to further define or describe 'finance providers'.

## Clarifying the phrases 'finance providers offering to pay amounts an entity owes its suppliers' and 'the entity agreeing to pay the finance providers'

### *Respondents' feedback*

14. A few respondents said the proposed description that SFAs involve one or more 'finance providers offering to pay amounts an entity owes its suppliers' is unclear. These respondents question whether the proposed description includes:

    (a) a supplier financing its receivables—by independently entering into an agreement with one or more finance providers without involving the buyer; and

    (b) a finance provider being the legal owner of the supplier's receivables—such that the entity owes the finance providers rather than the suppliers.

15. A few respondents said the phrase 'the entity agreeing to pay the finance providers' may be too narrow—because an arrangement may allow or require an entity to pay its suppliers, rather than the finance providers.

### *Staff analysis and recommendations*

#### *Financing of supplier receivables*

16. In our proposed description, an SFA 'is characterised by one or more finance providers offering to pay *amounts an entity owes its suppliers*…' [emphasis added]. In our view, these words make it clear that the focus is on the entity's liabilities, regardless of how the arrangement is legally structured—the focus is not on the supplier's receivables. Additionally, nothing in the scope suggests the entity is required to determine what actions its suppliers have taken to finance their receivables. Therefore, in our view, no change to the scope related to suppliers financing their receivables is needed. In explaining the IASB's decisions regarding scope, the Basis for Conclusions can emphasise that SFAs involve an entity financing its liabilities (amounts owed) to suppliers.

#### *Payments to finance providers or suppliers*

17. We learned through the feedback and our outreach that, in a typical SFA, the entity decides which of its supplier obligations become part of the arrangement. The finance provider may then give instructions to the entity (buyer) about making payment—including to whom to make a payment, in what amounts and on what dates. The finance provider may (or may not) become the legal owner of the supplier's receivables as a result of the arrangement. The payment instructions may direct the entity to pay another party—or the supplier.

18. Accordingly, we think our proposed description of SFAs inadvertently narrows the scope by specifying that the entity is ‘agreeing to pay the finance providers’. We therefore recommend revising the scope to specify that an SFA is characterised by the entity ‘agreeing to pay according to the terms and conditions of the arrangement’ (new words underlined) rather than ‘agreeing to pay the finance providers’. We expect this revision to better align our scope with the manner in which arrangements operate without being prescriptive about whom the entity will pay, which will be determined by the terms and conditions of the arrangement.

## Restricting the scope

### *Respondents’ feedback*

19. Many respondents questioned whether the scope should include all types of SFAs and suggested ways to restrict the scope. Some respondents suggested restricting the scope to include only arrangements with particular effects—or particular degrees of effect—as determined by the entity. For example, an arrangement would be in scope only if it:

    (a) affects the entity’s working capital, cash flows, debt levels or concentration of liquidity risk;

    (b) changes the ‘original’ terms and conditions negotiated between the entity and its suppliers or changes the ‘ordinary’ payment terms; or

    (c) is an ‘outlier’ in terms of its size, the volume of suppliers being financed, the number of finance providers being used or the length of the payment timing benefit for the entity.

20. A few respondents suggested restricting the scope to SFAs under which the trade payable is derecognised applying IFRS 9 and a new financial liability is recognised—indicating that the trade payable was either extinguished or substantially modified because of the arrangement. The Agenda Decision *Supply Chain Financing Arrangements—Reverse Factoring* says ‘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’. These respondents suggested this assessment can then act as a scope requirement.

21. Some respondents suggested an explicit scope exclusion for SFAs in which an entity pays, or offers to pay, its suppliers using particular instruments or services—for example, payment processing services; credit cards; letters of credit; bank acceptance bills and negotiable securities; financial guarantees; and other forms of short-term financing such as import loans and overdraft facilities.

## *Staff analysis and recommendations*

### *Scope restrictions*

22. Investors said they are interested in a broad range of SFAs and their effects on an entity's financial position, cash flows and exposure to liquidity risk. Investors have different ways of assessing and understanding the effects of SFAs; they employ different models in their analysis. Additionally, for purposes of their analysis, investors may classify an entity's liabilities differently than the entity has done.

23. We are aware there may be diversity in how entities determine, applying IFRS 9, when a modification results in derecognition. Additionally, under some reverse factoring arrangements an entity's liabilities to suppliers are not legally extinguished or substantially modified *by the arrangement* but, rather, changes are negotiated separately with suppliers in the light of the arrangement being in place (or expected to be in place soon).

24. In our view, therefore, our scope would not meet investor needs if we were to restrict the scope based on either an arrangement's particular effects or degrees of effect—as determined by the entity—or an entity's application of the derecognition requirements in IFRS 9. The IASB's approach, as described in paragraph BC10 of the Basis for Conclusions on the Exposure Draft, remains valid: to describe SFAs in a manner that would capture all arrangements that provide financing of amounts an entity owes it suppliers in a similar way to reverse factoring arrangements. The scope is not affected by variations in the form or labelling of arrangements or how an entity presents and classifies the related liabilities and cash flows.

### *Payment instruments*

25. Particular types of payment instruments or services may not be within the proposed scope of the new requirements because:

    (a) they directly settle a buyer's liability to its supplier—such as credit cards, particular types of letters of credit and bank acceptance notes;

    (b) they serve only as a backstop and credit enhancement to facilitate a transaction—such as financial guarantees and other types of letters of credit; or

    (c) they do not 'provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date.'—such as payment processing services.

26. We have not analysed all forms of trade finance transactions; an entity would need to do its own analysis as to whether particular arrangements would be within the scope of the requirements. We will consider in

drafting whether to add examples to the scope paragraph to illustrate the types of payment arrangements or instruments that are outside the scope.

### Other comments

27. Respondents provided other suggestions that we analyse below:

| Respondents' suggestion | Staff analysis and recommendations |
|---|---|
| Add wording from paragraph BC8 of the Basis for Conclusions on the Exposure Draft to the description of an SFA to clarify the scope. | The description of an SFA already includes the key elements of paragraph BC8: SFAs provide the entity with extended payment terms or the entity's supplier with early payment terms. We recommend retaining the explanation in paragraph BC8 and not revising the description. |

## Question for the IASB

Does the IASB agree with our recommendations set out in paragraph 3 of this paper to:

(a) make no change in response to suggestions to add characteristics;

(b) make no change to further define or describe 'finance providers';

(c) make no change to the scope related to suppliers financing their receivables;

(d) revise the scope to specify that an SFA is characterised by the entity 'agreeing to pay according to the terms and conditions of the arrangement' rather than 'agreeing to pay the finance providers';

(e) make no change to introduce scope restrictions based on:

(i) particular effects—or degrees of effect—of an arrangement as determined by the entity; or

(ii) application of the derecognition requirements in IFRS 9; and

(f) make no change to add explicit scope exclusions for arrangements involving particular types of payment instruments—and consider in drafting whether to add examples to the scope paragraph to illustrate the types of payment arrangements or instruments that are outside the scope of the disclosure requirements.