Staff paper

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IASB® meeting

Date	**November 2022**
Project	**Supplier Finance Arrangements**
Topic	**Feedback Analysis—Examples and other comments**
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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 on proposals in the Exposure Draft *Supplier Finance Arrangements* to add supplier finance arrangements (SFAs) as an example to existing disclosure requirements about:

   (a) non-cash changes as part of changes in liabilities arising from financing activities in IAS 7 *Statement of Cash Flows*; and

   (b) liquidity risk and concentrations of risk in IFRS 7 *Financial Instruments: Disclosures.*

2. This paper also analyses other comments on the Exposure Draft.

Structure of the paper

3. This paper includes:

   (a) summary of staff recommendations;

   (b) staff analysis and recommendations, including:

      (i) IASB's proposals and rationale;

      (ii) respondents' feedback[1]; and

      (iii) staff analysis and recommendations; and

   (c) question for the IASB (included after paragraph 22).

[1] Agenda papers 12D (examples added to disclosure requirements) and 12E (other comments) for the July 2022 IASB meeting summarised respondents' feedback on these matters.

Summary of staff recommendations

4. We recommend that the IASB:

   (a) not proceed with the proposed change to paragraph 44B of IAS 7 to provide SFAs as an example of a non-cash change in liabilities arising from financing activities. We make an alternative recommendation in Agenda Paper 12E for this meeting;

   (b) proceed with the proposed amendments to paragraphs B11F(j) and IG18 of IFRS 7 but not proceed with adding an example to paragraph B11F(a) of IFRS 7; and

   (c) make no changes in response to feedback to be more prescriptive about the required disclosures of liquidity risk and concentrations of risk arising from SFAs.

Staff analysis and recommendations

Non-cash changes in IAS 7

IASB's proposals and rationale

5. The IASB proposed to add SFAs as an example in a new sub-paragraph to the section in IAS 7 about changes in liabilities arising from financing activities [new text is underlined]:

> **Changes in liabilities arising from financing activities**
>
> **44A An entity shall 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.**
>
> 44B To the extent necessary to satisfy the requirement in paragraph 44A, an entity shall disclose the following changes in liabilities arising from financing activities:
>
> (a) changes from financing cash flows;
>
> (b) changes arising from obtaining or losing control of subsidiaries or other businesses;
>
> (c) the effect of changes in foreign exchange rates;
>
> (d) changes in fair values;
>
> <u>(da) non-cash changes arising from supplier finance arrangements (as described in paragraph 44G), for example when future cash outflows will be classified as cash flows from financing activities; and</u>
>
> (e) other changes.

6. Paragraph BC16 of the Basis for Conclusions on the Exposure Draft says users of financial statements (investors) find it difficult to understand the effects of SFAs on an entity's operating and financing cash

flows. To help in this respect, the IASB decided to add an example in paragraph 44B of IAS 7 to highlight the importance of providing information about non-cash changes in liabilities arising from financing activities that arise from SFAs. Such non-cash changes may not be apparent to investors without the disclosure highlighted by the proposed amendments to paragraph 44B.

7. Paragraph BC16 also provides an example of when this may be the case. We expand that example below by using numbers:

An entity buys goods and services valued at CU100 on credit from a supplier. The entity enters the resulting trade payable into an SFA. The entity—having considered the terms and conditions of the arrangement—classifies the cash outflow to settle the payable of CU100 as a cash flow from *financing* activities without having reported any cash inflow from financing activities. In effect, there has been a non-cash transfer from what would typically be a cash outflow from operating activities—for payments to suppliers—to a cash outflow from financing activities. This non-cash change may not be apparent to investors without disclosure.

Effect on the entity's statement of cash flows:

	Origination of payable for goods and services	**Non-cash transfer**	**Settlement of the payable through the SFA**
Cash flows from operating activities	CU100	(CU100)	-
Cash flows from financing activities	-	CU100	(CU100)

Respondents' feedback

8. Most respondents agreed with the proposals, largely for the reasons explained in the Exposure Draft, to add SFAs as an example within the requirements to disclose information about changes in liabilities arising from financing activities.

9. Many respondents raised questions about the applicability of the non-cash changes example to operating cash flows. In particular, many respondents said proposed paragraph 44B(da) focuses only on the effect of SFAs on the changes in liabilities arising from financing activities; that paragraph either is unclear about, or explicitly excludes, the corresponding effect on changes in liabilities arising from operating activities. Some respondents suggested that the IASB address this by extending the disclosure requirement for non-cash transactions in paragraph 43 of IAS 7 to operating transactions.

Staff analysis and recommendations

10. The feedback suggests that respondents supported disclosure by an entity of information about the effect of SFAs on non-cash changes—but disagreed with the proposed approach of amending paragraph 44B of IAS 7. Paragraph 44B is in the section of IAS 7 related to 'changes in liabilities arising from financing activities'—which leaves unclear whether disclosure of non-cash changes in liabilities arising from *operating* activities would also be required.

11. In the light of the feedback, we think a better approach is for the IASB to add a requirement for an entity to disclose the effect of transactions or reclassifications—including non-cash changes due to reclassifications in the statements of financial position and cash flows—that cause the carrying amount of financial liabilities that are part of SFAs to not be on a comparable basis at the beginning and end of the reporting period. We discuss this recommendation in paragraphs 30–31 of Agenda Paper 12E.

12. We therefore recommend that the IASB not proceed with the proposed change to paragraph 44B of IAS 7 to provide SFAs as an example of a non-cash change.

Liquidity risk and concentrations of risk in IFRS 7

IASB's proposals and rationale

13. The IASB proposed to amend sub-paragraph (a) and add sub-paragraph (j) to paragraph B11F of IFRS 7 as follows [new text is underlined]:

> B11F Other factors that an entity might consider in providing the disclosure required in paragraph 39(c) include, but are not limited to, whether the entity:
>
> (a) has committed borrowing facilities (eg commercial paper facilities) or other lines of credit (eg stand-by credit facilities <u>or supplier finance arrangements (as described in paragraph 44G of IAS 7)</u>) that it can access to meet liquidity needs;
>
> …
>
> <u>(j)</u> <u>has supplier finance arrangements (as described in paragraph 44G of IAS 7) that provide the entity with extended payment terms or that provide the entity's suppliers with early payment terms.</u>

14. The IASB also proposed to amend paragraph IG18 of IFRS 7 as follows [new text is underlined, deleted text is struck through]:

> IG18 Paragraph 34 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise…

> Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities, ~~or~~ reliance on a particular market in which to realise liquid assets, or supplier finance arrangements (as described in paragraph 44G of IAS 7) resulting in the entity concentrating with finance providers a portion of its financial liabilities originally owed to suppliers…

15. As explained in paragraphs BC21–BC22 of the Basis for Conclusions on the Exposure Draft, SFAs often give rise to liquidity risk because, by entering into such an arrangement, an entity typically has concentrated a portion of its liabilities with one or a few finance providers (rather than a diverse group of suppliers). Investors need information to help them assess the effect of SFAs on an entity's exposure to liquidity risk and risk management. The liquidity risk disclosure requirements in IFRS 7—which apply to recognised and unrecognised financial instruments—are already comprehensive. The IASB decided that there is no need to add to them as part of this project but instead decided to add SFAs as an example within the liquidity risk disclosure requirements in IFRS 7 to highlight the importance of providing liquidity risk information about these arrangements.

Respondents' feedback

16. Most respondents agreed with the proposals, largely for the reasons explained in the Exposure Draft, to add SFAs as an example within the requirements to disclose information about an entity's exposure to liquidity risk.

17. Some respondents raised concerns including:

    (a) the proposed amendments to paragraph B11F would result in no change in disclosure practices because of the way the proposed amendments are worded—in particular because paragraph B11F would refer to an entity's SFAs as one of a number of 'other factors' that an entity 'might consider' in providing disclosures; and

    (b) the proposed amendments to paragraph B11F(a) incorrectly imply that all SFAs are 'other lines of credit' or are similar to credit facilities or akin to loans, which may not always be the case.

18. Some respondents provided suggestions or asked for clarifications, including that the IASB:

    (a) clarify whether the proposed amendments to paragraph IG18 would require disclosure of a 'whole chain' of finance providers involved in an SFA; and

    (b) explicitly require disclosure of concentrations of risk arising from owing amounts to a specific supplier finance provider or providers and be more specific about information to be disclosed—such as numbers and names of finance providers and any factoring limits.

Staff analysis and recommendations

19. In proposing to add SFAs as an example within the liquidity risk disclosure requirements in IFRS 7, the IASB did not intend to change those existing requirements. Paragraph B11F's 'factors that an entity might consider' are not intended to be all-inclusive. Similarly, paragraph IG18 provides examples of situations in which 'concentrations of liquidity risk may arise'. We think respondents' suggestions are unnecessary and would represent more significant change to the existing requirements in IFRS 7 than was intended. We recommend that the IASB proceed with its proposed amendments to paragraphs B11F(j) and IG18 of IFRS 7.

20. As stated in paragraph 15, the liquidity risk disclosure requirements in IFRS 7 are already comprehensive. In developing its proposed amendments to IFRS 7, the IASB sought to highlight the importance of entities providing liquidity risk information about SFAs without adding requirements or being overly prescriptive. In our view, it would be overly prescriptive for the IASB to specify that an entity disclose, for example, names of finance providers involved in an entity's SFAs or to direct how far an entity should go in the 'chain' of finance providers when assessing liquidity risk. We therefore recommend no changes in response to feedback that the IASB be more prescriptive about required disclosures of liquidity risk and concentrations of risk arising from SFAs.

21. We are persuaded by respondents' comments that the wording of our proposed amendments to paragraph B11F(a) may incorrectly imply that all SFAs are—or are similar to—lines of credit. Having considered respondents' feedback, we think the proposed amendment to paragraph B11F(j) is sufficient to highlight that entities need to consider their SFAs when developing disclosures about liquidity risk. We therefore recommend that the IASB not proceed with adding an example to paragraph B11F(a). We will consider in drafting the amendments ways to clarify that paragraph B11F(j) is intended to capture an entity's liquidity risk associated with SFAs both when they have been used (have been accessed to meet liquidity needs and may represent a concentration of funding sources) and are available to be used (but could be withdrawn during times of stress).

Other comments

Respondents' feedback

22. The following table sets out respondents' other comments and our analysis of those comments:

Respondents suggested that the IASB:	Staff analysis and recommendations
(a) require disclosure about an entity's accounting policies and its assumptions and judgements for its arrangements;	We recommend no change because paragraphs 117-122 of IAS 1 *Presentation of Financial Statements* already require disclosure of material accounting policy information and the most

	significant judgements (apart from those involving estimations) that the entity has made in the process of applying its accounting policies.
(b) develop illustrative examples or educational material to assist entities in applying requirements related to SFAs;	We recommend no change because the wide variety of arrangements today (and possible new arrangements in future) would result in an illustration of one particular arrangement being of limited use.
(c) clarify that the illustrative example that accompanies IAS 7 'Reconciliation of liabilities arising from financing activities' does not involve an entity with SFAs;	The illustrative reconciliation of liabilities arising from financing activities currently includes long-term borrowings and lease liabilities. In our view these labels do not suggest that the liabilities include those that are part of SFAs—and it is unnecessary to explicitly state so. Our recommendation, if the IASB agrees, to remove the example in paragraph 44B of IAS 7 also reduces the need to make clarifications to the illustrative example.
(d) consider amending IAS 2 *Inventories* to clarify how an entity applies the term 'normal credit terms';	We recommend no change because such an amendment would go beyond the narrow scope of this project about an entity's SFAs.
(e) consider the interactions of this project with related projects such as the Exposure Draft *Disclosure Initiative—Targeted Standards-level Review of Disclosures* and ongoing deliberations on the *Primary Financial Statements* project; and	We have considered the interaction with these other projects—see Agenda Papers 12C–12E.
(f) consider the US Financial Accounting Standards Board's (FASB) project on *Disclosure of Supplier Finance Program Obligations.*	In September 2022, the FASB issued Accounting Standards Update (ASU) 2022-04—*Liabilities—Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations* (FASB ASU). Where relevant, Agenda Papers 12C–12E include more detail about the FASB ASU.

Question for the IASB

Does the IASB agree with our recommendations set out in paragraph 4 of this paper to:

(a) not proceed with the proposed change to paragraph 44B of IAS 7 to provide SFAs as an example of a non-cash change in liabilities arising from financing activities. We make an alternative recommendation in Agenda Paper 12E for this meeting;

(b) proceed with the proposed amendments to paragraphs B11F(j) and IG18 of IFRS 7 but not proceed with adding an example to paragraph B11F(a) of IFRS 7; and

(c) make no changes in response to feedback to be more prescriptive about the required disclosures of liquidity risk and concentrations of risk arising from SFAs.