Supplier Finance Arrangements

Proposed amendments to IAS 7 and IFRS 7

Question 1—Scope of disclosure requirements The [Draft] Amendments to IAS 7 and IFRS 7 do not propose to define supplier finance arrangements. Instead, paragraph 44G of the [Draft] Amendments to IAS 7 describes the characteristics of an arrangement for which an entity would be required to provide the information proposed in this Exposure Draft. Paragraph 44G also sets out examples of the different forms of such arrangements that would be within the scope of the Board's proposals.

Paragraphs BC5–BC11 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Reply: SIRC of ICAI agrees with the proposal of IASB.

1.1 SIRC of ICAI supports a short-scope project to develop specific disclosure requirements for supplier finance arrangements that provide relevant information to users of financial statements. It also focusses the attention of preparers and auditors and facilitate enforcement by regulators. The proposed disclosure requirements will result in increased conformity with existing IFRS Standards. The proposed new disclosure requirements complement the current requirements in IFRS Standards. The proposals in this ED provide application guidance to them, when dealing with supplier finance arrangements.

1.2 The proposals in the ED are intended to complement the current requirements, and to assist users in understanding the effects of supplier finance arrangements on an entity's liabilities, cash flows, liquidity risk and risk management.

1.3 Under the IASB's proposed changes, reporting entities will be required to reveal the "key terms and conditions of a supplier finance arrangement" and aggregate amounts of payables for SCF arrangements, the payables "for which suppliers have already received payment from the finance provider" and information about the length of payment terms.

1.4 The proposed amendments will not define Payables Finance arrangements and instead explain the type of arrangements that are within its scope.

1.5 SIRC of ICAI further adds that there is a risk of a possible narrow interpretation of the scope of IFRS 7 which focuses on financial instruments since liabilities under supplier finance arrangements are not necessarily financial instruments and may not be captured within IFRS 7 disclosure requirements.

1.6 The project scope to focus on supplier finance arrangements are being used in practice, and they can significantly affect an entity's ability to settle its liabilities when they become due.

1.7 The amendments effectively address the issue treated by the agenda decision Supply Chain Financing Arrangements – Reverse Factoring. It is also a fact that there might be other similar arrangements related to working capital and liquidity risk management for

which there is a lack of disclosures. Such arrangements are increasingly used in practice and should be closely monitored by the IASB. Nevertheless, the information needs of users related to inventory financing arrangements are different from those for supplier finance arrangements. Therefore, that widening the scope of the project to a broader range of financing arrangements related to an entity's working capital may delay the project.

1.8 SIRC of ICAI agrees with the IASB proposal to explain the type of arrangements to be included in the project's scope to eliminate the potential risk for the possible definition becoming outdated, and reduce any structuring opportunities related to drafting contracts between an entity and its supplier and finance provider.

1.9 SIRC of ICAI suggests to IASB to elevate paragraph BC8 of the ED to become part of the proposed amendments to IAS 7. This will strengthen the description of supplier finance arrangements in paragraph 44G of the ED and clarify that both supplier finance arrangements providing early payment terms to suppliers and supplier finance arrangements providing extending credit terms to buyers are within the scope of the project.

1.10 SIRC of ICAI agrees that the proposed amendments will allow investors and other stakeholders, who rely on credit and equity valuations, to be better informed of Payables Finance programmes and attract more into the market.

1.11 In spite of above supports, it is to be mentioned that the project does not completely address the wider issue of providing necessary transparency on liquidity risk and how entities leverage their working capital to effectively derive finance; this includes presentation, classification and labelling in the statement of financial position, liquidity risk disclosures and relevance of the statement of cash flows in general.

1.12 The accounting for supplier finance arrangements will depend on the exact facts and circumstances relating to them. In addition, entities should consider how the accounting for supplier finance arrangements is impacted by COVID-19.

1.13 The reverse factoring is a significant funding alternative for certain industry sectors. Nevertheless, once can find a gap between the apparent prevalence of these transactions and the information disclosed in financial statements. It is stressed that the standards would need to be worded broadly so that firms cannot structure their arrangements to avoid disclosure.

1.14 One sticking point which has not yet been resolved is ratings agencies' view that payments expected beyond what is considered the industry norm, generally 90 days should be classified as bank debt. It will be an interesting area in which there can still be discussion and interpretation.

Question 2—Disclosure objective and disclosure requirements Paragraph 44F of the [Draft] Amendments to IAS 7 would require an entity to disclose information in the notes about supplier finance arrangements that enables users of financial statements to assess the effects of those arrangements on an entity's liabilities and cash flows.

To meet that objective, paragraph 44H of the [Draft] Amendments to IAS 7 proposes to require an entity to disclose:

(a) the terms and conditions of each arrangement;

(b) for each arrangement, as at the beginning and end of the reporting period:

(i) the carrying amount of financial liabilities recognised in the entity's statement of financial position that are part of the arrangement and the line item(s) in which those financial liabilities are presented;

(ii) the carrying amount of financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers; and

(iii) the range of payment due dates of financial liabilities disclosed under (i); and

(c) as at the beginning and end of the reporting period, the range of payment due dates of trade payables that are not part of a supplier finance arrangement.

Paragraph 44I would permit an entity to aggregate this information for different arrangements only when the terms and conditions of the arrangements are similar.

Paragraphs BC12–BC15 and BC17–BC20 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you agree with only parts of the proposal, please specify what you agree and disagree with. If you disagree with the proposal (or parts of it), please explain what you suggest instead and why.

Reply:

2.1 SIRC of ICAI is supportive of the direction of the project to improve disclosure requirements related to supplier finance arrangements. SIRC agrees to add an overall disclosure objective in IAS 7 to help users of financial statements understand the effects of supplier finance arrangements on an entity's liabilities and cash flows.

2.2 The proposed disclosures provide a timely improvement towards a more transparent reporting for supplier finance arrangements. However, future efforts are needed to address also classification and presentation of those arrangements in the statement of financial position and in the statement of cash flows. It is felt that providing a comprehensive package of disclosures that includes all disclosures related to supplier finance arrangements would be useful. Disclosing management's decision and judgements on how to present liabilities and cash flows related to reverse factoring or including

specific references related to supplier finance arrangements on when to present separately a financial liability might be useful.

2.3 The proposed specific disclosure requirements in IAS 7 is a good initiative as such disclosures will enable users to better understand an entity's financial position and performance and show its level of debt resulting from such arrangements. The proposals viz., requiring key disclosures on supplier finance arrangements to be located in a single place in the notes and ensuring that entities use consistent terminology when describing their supplier finance arrangements accounting policy are in in right direction.

2.4 The explicit disclosure of supplier finance arrangements - requiring information about the terms and conditions of each supplier finance arrangement would result in entities explicitly disclosing those arrangements with finance provider.

2.5 Further, disclosing the carrying amount of an entity's liabilities that are part of supplier finance arrangements and the line item in which they are presented in the statement of financial position will give an indication to users about the size and location of liabilities being part of such arrangements.

2.6 Disclosing the carrying amount of liabilities that are part of supplier finance arrangements together with the carrying amount of these liabilities for which suppliers have already received payment from the finance provider will be helpful to users to analyse an entity's level of debt and its effects on the operating and financing cash flows.

2.7 Disclosing the range of payment due dates of both financial liabilities that are part of each arrangement and trade payables that are not, will enable users to assess the extent to which operating cash flows improve as a result of the increased use of supplier finance arrangements by the entity;

2.8 Disclosing the carrying amount of financial liabilities for which suppliers have already received payment from the finance provider would provide information about the extent to which the entity has used extended payment terms or its suppliers have used early payment terms. Users would be able to assess an entity's exposure to liquidity risk if the arrangements were no longer available.

2.9 Requiring information at the beginning and end of each reporting period would help users identify any changes and trends in the usage of supplier finance arrangements and their effects on an entity's liabilities and cash flows.

2.10 It is a fact any entities that, as a buyer, enters into one or more supplier finance arrangements will be affected by these proposals and the intention of the amendment is to discourage such multiple supplier finance arrangements.

2.11 SIRC also notes that The proposed additional disclosures apply retrospectively, therefore information must be provided for all new disclosures in the comparative period.

2.12 SIRC of ICAI suggests the following improvements:

(i) when disclosing the terms and conditions of the arrangement, to consider whether it is useful to explain when and why the liability is classified as trade receivable or short-term debt. That is, an entity should disclose which terms and conditions lead to the classification as operating or financing.

(ii) to clarify whether the range of payment due dates in accordance with paragraph 44H(b)(iii) refer to payment due date to the finance provider or payment due date to the supplier. This is particularly important considering that supplier finance arrangements can be structured in different ways as explained in paragraph BC8 of the ED.

(iii) to consider whether there is a need to disclose separately the carrying amounts of liabilities depending on their classification as trade payables or a short-term debt.

(iv) to amend paragraph 44I of the ED to permit aggregation of information about different supplier finance arrangements not only when their terms and conditions are similar but also, in particular, when their payment due dates are similar;

(v) to amend paragraph 44H(a) to highlight that the materiality principle and the usefulness of information are the leading ones when reporting for supplier finance arrangements.

(vi) to clarify the usage of the term 'financial liability' when applied to supplier finance arrangements. In particular, whether liabilities disclosed under such arrangements have to be presented as financial liabilities in the statement of financial position;

(vii) to consider elevating the explanation in paragraph BC19 of the ED into the proposed amendments of IAS 7 in order to clarify that to the extent finance providers act as a paying agent on the entity's behalf the entity would be able to obtain this information from its paying agent. abilities and cash flows.

2.13 In practice, the impact of a supplier finance arrangement on the presentation of a financial liability is likely to involve a high degree of judgement based on the specific facts and circumstances. Whichever presentation is adopted, management should carefully consider the additional disclosures that will be necessary to explain the nature of the arrangements and the financial reporting judgements made.

Question 3—Examples added to disclosure requirements Paragraph 44B of the [Draft] Amendments to IAS 7 and paragraphs B11F and IG18 of the [Draft] Amendments to IFRS 7 propose to add supplier finance arrangements as an example within the requirements to disclose information about changes in liabilities arising from financing activities and about an entity's exposure to liquidity risk, respectively.

Paragraphs BC16 and BC21–BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Reply:

3.1 SIRC of ICAI agrees with the IASB proposal to add an example within the liquidity risk disclosure requirements in IFRS 7 to highlight the importance of providing liquidity risk information about supplier finance arrangements. This will enable users to better assess the effect of such arrangements on an entity's exposure to liquidity risk and their risk management. The importance of having disclosures on liquidity risks related to the fact that an entity concentrates part of its liabilities on a single finance provider and that an entity has become reliant to extended payment terms provided by the arrangement is to be appreciated.

3.2 It is opined that the concentration of liquidity risk varies depending on whether an entity has established supplier finance arrangements with only one finance provider or with a few different finance providers. Thus, if the arrangement is withdrawn, the entity could find itself in significantly different liquidity position based on how it diversifies its exposure to liquidity risk arising from different supplier finance arrangements with different finance providers. Therefore, IASB may consider adding an explicit proposal that would require disclosure of concentration of risk to specific supplier finance provider instead of supplier finance arrangements in general.

3.3 Further, when an entity does not report any operating cash flows because the gross up of the cash flows under supplier finance arrangement is not allowed, the effects of suppler finance arrangements on its cash flows may not be apparent to users of financial statements and obscure the reported information about such arrangements. Therefore, adding a disclosure in paragraph 44B of IAS 7 about changes in an entity's operating and financing cash flows is fundamental for users to understand the effects of such arrangements on an entity's cash flows. At the same time one has to take into account that in situations when a corporate entity does not report any operating cash flows related to payments to suppliers under supplier finance arrangements, the entity would significantly improve its operating cash flows metrics, which will result in unusual outcome in the statement of cash flows. In such situations, the gross presentation of cash flows under supplier finance arrangements in the statement of cash flows may provide more relevant information to users of financial statements. In addition, preliminary discussion with users indicated that gross presentation of cash flows related to supplier finance arrangements would provide them with better understanding of the transaction compared to simply disclosing non-cash changes in liabilities under such arrangements as proposed in paragraph 44B(da) of the ED. Therefore, prominence should be given to the presentation of cash flows under supplier finance arrangements which warrants consideration in the ED's proposals. It is suggested to remove the word 'non-cash' from

'non-cash charges arising from supplier finance arrangements' in paragraph 44B(da) of the ED as such arrangements can involve cash transfers as well.

3.4 Furthermore, the document should clarify whether gross cash flows may exist if, for example, the financial institution acts as an entity's paying agent in a reverse factoring arrangement. Also, the Board may consider to make cross-reference between paragraph 44F and paragraph 44B(da) of the ED as non-cash information is key when gross up presentation is not allowed.