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Dear Mr. Barckow

Comment letter on Exposure Draft ED/2021/10 *Supplier Finance Arrangements, Proposed amendments to IAS 7 and IFRS 7.*

We appreciate the opportunity to comment on the International Accounting Standards Board's ('the Board') Exposure Draft ED/2021/10 *Supplier Finance Arrangements, Proposed amendments to IAS 7 and IFRS 7* ('the ED'), published in November 2021. We have consulted with, and this letter represents the views of, the KPMG network.

We welcome the Board's initiative to develop additional disclosure requirements about supplier finance arrangements (SFA) in the financial statements. The enhanced transparency on SFAs should provide more decision useful information.

Given the immediate need for enhanced disclosures on such arrangements, we support the Board's proposed amendments, subject to some clarifications, primarily in respect of the scope. While we encourage a broad scope to promote transparency and prevent possible structuring, we believe that additional clarifications are needed as the current proposals may inadvertently scope in traditional factoring arrangements. We also ask the Board to consider if the proposed disclosures are fit for purpose, considering the different legal forms and structures of these arrangements (see our response to Question 1).

We note that the Board's proposals do not address the wider issue of presentation and classification of SFA in the primary financial statements. In the absence of specific guidance in IFRS Standards on the classification of cash flows for an entity that is the customer (buyer) in an SFA, the proposals, if finalised, would not fully address investors' expectations. Investors will likely continue to express concerns that, some entities may inappropriately present inflated cash flows from operating activities. Depending on presentation judgements made by the entity presenting a single *financing* cash outflow may significantly affect the statement of cash flows – e.g. in an extreme case, if all of the entity's payables were reverse factored, then there would be no operating cash *outflows* presented for purchases of goods or services.

Neither the proposed amendments, nor the IFRIC agenda decision provide clarity on this aspect – in particular, how to determine if *cash flows occur* or *do not occur for an entity* when an invoice is factored and depending on the assessment, whether an entity should present a single cash outflow for the payments made to the factor or multiple cash flows – i.e. gross cash flows. It remains unclear whether an agent/principal analysis would be appropriate and how entities should perform such analysis. Without specific guidance, diversity in practice will likely continue.

To fully address investors' concerns, specific guidance on the presentation of cash flows that represent payments of invoices which are part of an SFA is needed.

We appreciate the Board's rationale in paragraph BC20 for why this issue cannot be addressed within the scope of this project (i.e. it would likely require wider considerations than cash flows related to SFA). However, we believe an explicit disclosure requirement (i.e. in the notes) as to how an entity classifies cash flows related to its SFA would provide users with more transparency and fill a specific user information gap – this is because the ultimate classification may not always be apparent from the presentation of the statement of cash flows itself. We recommend that the Board consider adding a specific disclosure requirement before finalising the amendments.

Longer-term considerations

In order to respond to imminent user needs, we support the Board's approach in this narrow-scope project to focus solely on disclosures of SFA and their effects on entities' liabilities and cash flows – i.e. not addressing broader presentation issues at this stage.

Nevertheless, we strongly recommend revisiting the broader issues at a future date with a view to expanding the project's scope, based on an informed outreach with users:

- to address cash flow statement presentation issues as part of a more comprehensive review of IAS 7 *Statement of Cash Flows*¹, and
- to encompass SFA as well as other types of financing arrangements (traditional factoring arrangements, or other forms of financing – e.g. financing inventory).

Lastly, given the level of granularity of the proposed disclosures and the Board's efforts to discourage a checklist approach to financial statement disclosures and encourage more effective materiality judgements under its Disclosure Initiative projects, we recommend the Board consider the interactions with related projects such as Exposure Draft *Disclosure Requirements in IFRS Standards – A Pilot Approach* and ongoing deliberations of the Primary Financial Statements project (response to Exposure Draft *General Presentation and Disclosures*).

¹ See KPMG comment letter response to the Board's Request for Information *Third Agenda Consultation*.



We have set out our detailed comments and responses to the specific questions in the ED in the appendix to this letter.

Please contact Reinhard Dotzlaw at reinhard.dotzlaw@kpmgifrg.com or Gabriela Kegalj at gabrielakegalj@kpmg.ca if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix: Responses to specific questions

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.

The current proposals are too ambiguous and in the absence of further clarifications could be misapplied. It is important that the scope is further clarified. We highlight below a few areas where additional clarifications are needed.

Purpose of the arrangement

The proposed amendments seem to suggest a broad scope such that the proposed disclosure requirements would apply not only to arrangements that provide *financing to customers (buyers)*, but also those that *provide financing to suppliers* or are merely providing *payment processing* which do not provide financing to any party.

We support a broad scope to promote transparency and prevent possible ‘structuring’ by entities in order to avoid disclosure.

We recommend that the proposed general characteristics are more clearly articulated within the proposed paragraph 44G and the Board explicitly acknowledge that a broad scope is intended.

We also believe that disclosure of an entity’s purpose for entering into SFAs would be helpful. See our recommendation in response to Question 2.

Distinguishing between SFA/reverse factoring and ordinary factoring arrangements

We acknowledge the Board’s intention per paragraph BC11 to exclude from the scope of the amendments factoring of receivables. However, we note that the proposed wording in paragraph 44G (*‘the entity agreeing to pay the finance providers at the same date as, or a date later than, suppliers are paid’*) may inadvertently scope in ordinary factoring arrangements. Consider the arrangement in the following example:

Example 1. A supplier and a bank enter into an arrangement whereby the supplier will factor its receivables. Under the arrangement, approved invoices are assigned to the bank (i.e. the bank becomes the principal). The supplier and the bank get permission in advance for the supplier’s trade debtors (i.e. the entity, being the supplier’s customer) to pay the bank directly for qualifying payables. However, because the entity is ‘making an agreement’ to pay the finance provider directly after the supplier is being paid, it appears to fall in scope of paragraph 44G as a reverse factoring arrangement from the entity’s perspective – when all the entity did was to agree to pay a bank instead of a supplier and its only ‘agreement’ was merely agreeing to the assignment.

We don’t believe such arrangements should be in scope as these are not SFAs. We suggest the Board ring-fence the definition so as not to inadvertently scope in some ordinary/traditional factoring arrangements. It is important to clearly distinguish arrangements that are in scope from those that are not in scope. For example, it may be helpful to clarify that traditional factoring is typically initiated by the supplier and the factor; in contrast, reverse factoring is usually initiated by the customer/buyer and the factor.

Ability to obtain financing

Additional clarity regarding the scope is also needed for an arrangement that exists to provide a buyer with the ability to obtain financing from the factor but the buyer has not yet used this option during the reporting period. Consider the following example:

Example 2. A buyer enters into an arrangement for supplier’s invoices that offer 90-day settlement terms. Suppliers get paid on T +90 by the finance provider/bank, but the buyer can choose, if it wishes, to pay on T +180 (and will also pay an appropriate rate of interest as a result). Is this an SFA in scope if the buyer hasn’t chosen to but is able to extend the term? What if the buyer were taking 180 days to pay during periods of weeks or months *in the year* but as at the reporting date have paid the supplier invoices at T +90 (i.e. despite the option existing under the arrangement, no extended terms are being used)?

Applicability if the arrangement was only in force for part of the year

The Board should also clarify whether an SFA needs to be in force *throughout* the financial year, or at any time during the year to trigger the proposed disclosure requirements, or just the end of the year (i.e. at the end of the reporting period). Otherwise, there is potential risk that these requirements may be ignored if there is no arrangement in place at the end of the reporting period. We believe that disclosures should apply if the entity was a party to such arrangements at any time during the reporting period.

Extended payment/credit terms

We believe that, for purposes of scoping, it is important that all relevant characteristics of SFA are included in the body of IAS 7 *Statement of Cash Flows*. If the Board intends the scope of the proposed amendments to be broad, the additional guidance in paragraph BC8 should be part of the standard itself.

The guidance in BC8 seems to suggest that SFA are in scope regardless of whether an entity obtains an extension of credit terms from the finance provider – i.e. this may capture arrangements in which the entity:

- does *not* obtain an extension of credit from the finance providers – i.e. it pays the finance provider on the invoice due date (regardless if the entity negotiated extended payment terms with its suppliers), or
- obtains an extension of credit terms from the finance providers – i.e. it pays the finance providers at a date later than the invoice due date; the finance providers pay suppliers the amounts they are owed by the entity on the invoice due date.

The Board should explain/address what is meant by “regardless if the entity negotiated extended payments terms with its suppliers” as this phrase could be misinterpreted. The proposed paragraph 44G suggests that extended payment terms are determined purely by comparison to the invoice payment due date, however, in some arrangements the invoice due dates could be extended compared to typical payment terms.

In practice, an SFA is sometimes accompanied by a revision to the contractual terms between the supplier and the entity (the buyer/customer). Consider the following example:

Example 3. Previously credit terms were 30 days (absent an SFA arrangement in place). Following the SFA, the parties agree to extend the credit terms to 60 days. The supplier can be paid at 60 days or get their cash from the finance provider (factor) at 30 days for a discounted amount. The parties also agreed a small increase in the invoice price when they agreed to extend the credit terms to 60 days.

In our view, such arrangements should be in scope. Under a narrow scope, this arrangement would not be subject to the proposed disclosure requirements as there is no extended credit provided to the entity. However, under a broad scope, it would need to be disclosed – in this way investors could understand and assess whether the entity has effectively accepted an increased invoice price in return for extended credit terms.

A narrow interpretation of the scope may lead to structuring opportunities. As such, we believe the scope should be interpreted broadly.

In view of the comments above, we recommend that the scope is further clarified and any proposed disclosures are fit for purpose considering the different legal forms and structures of these arrangements. The Board may consider providing illustrative examples for different types of arrangements. See our response to Question 2.

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.

Overall approach to disclosures

We support the Board's proposed disclosure objective stated in paragraph 44F as it helps entities to understand why information on SFA may be relevant. As the proposed disclosure requirements are very detailed, we believe entities would need to determine what information needs to be provided in view of the stated disclosure objective based on materiality – i.e. only material information needs to be disclosed. It would be helpful for the Board to acknowledge this in the Basis for Conclusions.

We have the following comments on the suggested disclosure requirements.

Specific disclosures on presentation of related cash flows

The proposed disclosure requirements in IAS 7 focus on disclosure of liabilities or changes in liabilities rather than disclosure of the effects on cash flows more broadly. Given the broad objective in paragraph 44F explicitly referring to ‘effects on cash flows’ and investors’ calls for more transparency on the impacts of these arrangements on an entity’s cash flow statement, we recommend the Board explicitly require disclosure in the notes of the amounts of cash flows related to SFAs and the category(ies) of the cash flow statements in which they are included, together with a related accounting policy on how an entity has classified cash flows related to its SFAs. The ultimate classification may not always be apparent from the presentation of the statement of cash flows itself.

Disclosure of amounts already paid by the factor to suppliers (para 44H(b)(ii))

We question if the proposed requirement in paragraph 44H(b)(ii) to disclose the carrying amount of financial liabilities for which suppliers have already received payment from the finance providers is practical in all circumstances. We also note that this disclosure is not included in the recently published US FASB proposals on disclosure of supplier finance program obligations.

While we acknowledge the Board’s expectations in paragraph BC19, we recommend the Board reconsider if such disclosure is useful to investors, assess cost-benefit and practicability.

We note that the commentary in para BC19 may imply that in all or most of these arrangements the ‘finance provider’ acts as an agent on the entity’s behalf. This comment may have unintended consequences given that the proposed amendments do not provide any guidance on when cash flows *occur/do not occur* for the entity and how to make such determination. We urge the Board to revisit the wording in BC19 before amendments are finalised.

Disclosure of liabilities at the beginning and end of the reporting period (paragraph 44H)

We request clarification of the proposed requirement in paragraph 44H to disclose information about SFAs “at the beginning and end of the reporting period” (emphasis added) given the requirements in IAS 1 on presentation of comparative information and presentation of a third statement of financial position. We believe that requiring disclosures at the beginning of the reporting period when comparatives are presented is onerous. This effectively means that if the entity presents one year of comparative information it will also be required to disclose this information at the beginning of the comparative period. We do not believe that entities should be required to disclose such information unless they are required to present a third statement of financial position.

Disclosure of terms and conditions and aggregation (paragraph 44H(a) and 44I)

We are concerned that the proposed disclosure in paragraph 44H(a) is more onerous than what IFRS 7 currently requires for financial liabilities and ask for clarification on what key terms need to be disclosed (emphasis added).

However, we believe that there are certain terms that should be disclosed – e.g. cost of funding/interest rate. If the customer/buyer benefits from funding, users may want to know if the entity is reliant on this funding and is exposed to additional risks – e.g. liquidity/going concern risks. Hence it would be useful to know how much the funding received by the entity is costing compared to normal working capital funding. The Board may consider including an explicit requirement to disclose the cost of funding.

In addition, we question the interaction of the proposed requirement in paragraph 44H(a) to disclose the terms and conditions of each SFA and para 44I that permits aggregation of information when terms and conditions of such arrangements are *similar*.

In order to drive consistency and comparability, it would be helpful to refer to 'key terms and conditions' and provide guidance on the following:

- what key 'terms and conditions' need to be disclosed so as not to obscure other material information in the notes, and
- if an entity enters multiple SFAs, how an entity would assess if the terms and conditions are *similar* to allow aggregation.

In order to ensure that aggregation does not result in a loss of material information, we suggest the Board consider explicitly requiring an entity with multiple SFAs to disclose this fact and that their terms and conditions were judged to be similar and the basis for such judgement.

Considering entities may enter into SFAs for various reasons and using different structures, we recommend that the Board introduce a requirement for entities to disclose their purpose for entering into such arrangements.

Illustrative examples

Given the proposals' broad scope (based on the proposed paragraph 44G) may potentially include arrangements that provide a finance benefit to the supplier rather than the buyer, we ask the Board to consider providing illustrative examples of what the disclosure in paragraph 44H would look like for different arrangements and test that the proposed disclosures are fit for purpose and respond to users' needs.

Educational material/guidance is fragmented

In order to facilitate their effective application, given the proposed disclosure requirements build upon and complement existing disclosure requirements in IAS 1, IAS 7 and IFRS 7, it would be useful to collate all relevant presentation and disclosure requirements (subject to materiality considerations) that apply to SFAs in a single document, possibly educational material. This may encourage appropriate and timely

implementation. Preparers would still need to consider IFRS Standards (existing and newly proposed requirements) and additional guidance in the IFRIC agenda decision but they could access relevant guidance in one place.

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.

We support the Board's proposed examples introduced within IAS 7 and IFRS 7.

However, we question the need for the disclosure proposed in IFRS 7 paragraph B11F(j) given the broad scope that is being proposed – i.e. arrangements that provide the entity's suppliers with early payment terms - as such arrangements may not affect liquidity risk for the entity if the entity continues to pay the finance provider at the contractual invoice due date.

In addition, as noted in our general comments (cover note), we believe there is a need to address the presentation of cash flows related to SFAs as part of a comprehensive review of IAS 7 in the near future.