



STAFF PAPER

April 2020

IFRS® Interpretations Committee meeting

Project	Supply Chain Financing—Reverse Factoring		
Paper topic	Research summary		
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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (Committee) and does not represent the views of the International Accounting Standards Board (Board), the Committee or any individual member of the Board or the Committee. Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Decisions by the Board are made in public and reported in IASB® *Update*. Decisions by the Committee are made in public and reported in IFRIC® *Update*.

Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about supply chain financing arrangements.
2. The submission asks:
 - (a) how an entity classifies its rights and obligations to which supply chain financing arrangements relate (for example, how it classifies its obligation to pay for goods or services received when those invoices are part of a supply chain financing arrangement); and
 - (b) what an entity is required to disclose in its financial statements about supply chain financing arrangements.
3. The submission identifies reverse factoring and dynamic discounting as two types of supply chain financing arrangement, but asks more widely about the disclosure requirements for supply chain financing arrangements.
4. This paper provides the Committee with a summary of:
 - (a) the prevalence of supply chain financing arrangements (paragraphs 8–26);
 - (b) the key terms of reverse factoring arrangements (paragraphs 27–40); and

- (c) how entities account for reverse factoring arrangements (paragraphs 41–51).
- 5. Appendix A reproduces the submission.
- 6. This paper does not ask the Committee to make any decisions—it provides only background information about supply chain financing arrangements that we have obtained from our research and outreach. We thought it would be helpful for Committee members to become familiar with such arrangements at the April 2020 meeting.
- 7. We then plan to bring a paper to the June 2020 Committee meeting that includes (a) staff analysis of the application of IFRS Standards to such arrangements; and (b) staff recommendations for the Committee’s consideration.

How common are supply chain financing arrangements?

- 8. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators, and large accounting firms. The submission was also made available on our website.
- 9. The request asked those participating to provide information about whether, based on their experience, supply chain financing arrangements are common. If so, we asked respondents to provide information about the most common types of supply chain financing arrangement. We also asked those participating to provide information about how entities account for supply chain financing arrangements.
- 10. We received 13 responses—seven from national standard-setters, four from large accounting firms and two from organisations representing a group of securities regulators. The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

What are the common types of supply chain financing arrangement?

11. A few respondents view supply chain financing arrangements as encompassing a number of different arrangements. However, most respondents use ‘supply chain financing’ to mean ‘reverse factoring’.
12. Those respondents who view supply chain financing arrangements broadly identify three types of arrangement:
 - (a) Reverse factoring—an arrangement involving three parties: an entity that purchases a good or service, a supplier providing those goods or services and a financial institution. The arrangement typically allows the supplier to be paid by the financial institution at a date earlier than the entity pays the financial institution.
 - (b) Dynamic discounting—an arrangement between an entity purchasing goods and a supplier. The supplier offers a range of discounts that vary depending on when the entity settles its payable to the supplier. The discount is often designed to be highest on the date when the supplier would most like to be paid, with lower discounts for payment further from that date.
 - (c) Supplier inventory financing—a financial institution intermediary purchases an item of inventory from the supplier and sells it to the entity. This may enable the entity to obtain longer credit terms for the purchase of inventory than it would obtain if it were to receive the inventory directly from the supplier.
13. One respondent notes a transaction that produces a similar outcome to reverse factoring, but is not commonly considered supply chain financing. It is aware of entities that pay suppliers using a bill of exchange (or letter of credit). The supplier is able to present the bill of exchange (or letter of credit) to the entity’s financial institution to obtain payment, which can be made early for a discount. The entity pays the financial institution at the agreed expiry of the bill of exchange (or letter of credit).

14. Respondents that mention dynamic discounting say it is not common. In addition, only a few respondents mention supplier inventory financing, noting that it is common mainly for commodity purchases¹.

How common are supply chain financing arrangements in particular jurisdictions?

15. Respondents say reverse factoring arrangements are:
- (a) common in Australia, Brazil, China, Malaysia, Singapore, South Africa and South Korea; and
 - (b) not common in Japan.
16. A few respondents say reverse factoring arrangements are not common in Canada, Europe and Hong Kong, but their use is increasing. However, others say such arrangements are common in Belgium, Canada, Denmark, France, Germany, Hong Kong, the Netherlands, Spain, Switzerland and the UK.

Staff research

17. We used the financial search engine, AlphaSense, to search for disclosure of supply chain financing arrangements in entities’ most recent interim or annual financial statements. The search was limited to financial statements in English. We searched for ‘supply chain financing’ broadly, as well as the arrangements described in paragraph 12 of this paper.
18. Our search identified a total of 219 entities disclosing supply chain financing arrangements in their financial statements:
- (a) 145 entities disclose entering into supply chain financing arrangements;
 - (b) 14 suppliers disclose the receipt of funds in reverse factoring arrangements;
- and

¹ The Board will discuss supplier inventory financing as part of its consideration of commodity-related transactions at its April 2020 meeting.

- (c) 60 financial institutions offer supply chain financing arrangements to customers.

Entities entering into supply chain financing arrangements

19. Most entities disclosing that they enter into supply chain financing arrangements refer specifically to reverse factoring arrangements.
20. Some entities disclose that they enter into supply chain financing arrangements, but we were unable to identify the type or term of those arrangements. It is possible that, similar to outreach respondents, some entities in our search use ‘supply chain financing’ to mean ‘reverse factoring’. No entities disclose entering into dynamic discounting or supplier inventory financing arrangements.
21. Entities disclosing supply chain financing arrangements are based in 34 jurisdictions. In our analysis, entities disclosing supply chain financing arrangements are most commonly based in France, Poland, Spain and the UK.

Financial institutions

22. The financial institutions in our search are also based in many jurisdictions. Many of the entities we identified say they offer supply chain financing arrangements in China.
23. In addition, financial institutions in jurisdictions in the Middle East, South Asia and Southeast Asia say they have begun offering supply chain financing arrangements to customers over the past year. This indicates that, in those jurisdictions, supply chain financing arrangements may not be common at present but could become so in the future.

Other evidence

24. We have also reviewed some publicly available reports on reverse factoring:
- (a) The PwC SCF barometer 2018/2019² indicates that around 50% of respondents to a survey already have a reverse factoring agreement in place, with a further 40% considering doing so.
 - (b) A Fitch report published in July 2018³ estimates that there has been an increase in payables being factored of USD 327bn since 2014. It also says it is often difficult to identify from an entity's financial statements whether it has entered into a reverse factoring arrangement.

Staff conclusion

25. The submission identifies several types of supply chain financing arrangement. The information obtained from outreach and our own research (see paragraphs 11–24 above) indicates that the most common type of arrangement is reverse factoring. Indeed, many respondents use 'supply chain financing' to mean 'reverse factoring'. We have also spoken to the submitter and we understand the focus of their question is on reverse factoring arrangements.
26. Accordingly, for the remainder of this paper we discuss only reverse factoring arrangements.

How do reverse factoring arrangements work in practice?

27. As noted above, reverse factoring arrangements involve (a) a financial institution paying an entity's suppliers amounts owed by the entity, and (b) the entity paying the financial institution. We understand reverse factoring arrangements are often set up by large corporates with good credit ratings. Reverse factoring arrangements can

² <https://www.pwc.com/my/en/assets/services/deals/20181218-SCF-Barometer-2018-2019-final-report.pdf>

³ <https://www.fitchratings.com/research/corporate-finance/what-investors-want-to-know-supply-chain-finance-27-07-2018>

facilitate an entity's suppliers using the entity's credit rating to obtain financing at a cost lower than the supplier would be able to obtain itself.

28. The terms of reverse factoring arrangements vary depending on the agreement between the entity, its suppliers and the financial institution. We have identified two broad types of reverse factoring arrangement—those primarily set up to enable:
 - (a) an entity's suppliers to receive payment for their trade receivables before the due date (paragraphs 34–38); and
 - (b) an entity to settle trade payables later than the due date (paragraphs 39–40).

29. Although we have identified two broad types, we note that a reverse factoring arrangement may benefit both the entity and its suppliers. For example, even though a reverse factoring arrangement may be set up to enable an entity to settle trade payables later than their due date, that arrangement may also enable suppliers to access payment for those balances before the due date.

30. In both types of reverse factoring arrangement, information is typically exchanged between the parties to the arrangement through the use of a 'platform' offered by the financial institution to the entity. When an entity receives an invoice from a supplier and is satisfied with the goods or services received, the entity uploads the invoice information to the platform. This may be in conjunction with an irrevocable payment undertaking, which confirms the entity's intention to pay the invoice.

31. Platforms can be used by an entity to manage their trade payables. An entity may upload information about all its trade payables (including invoices from suppliers not participating in the reverse factoring arrangement). If an entity's suppliers participate in a reverse factoring arrangement, the invoice's inclusion on the platform informs the financial institution that the amount could potentially be factored.

32. In some reverse factoring arrangements, the financial institution may also act as the entity's paying agent. In that case, the financial institution:
 - (a) assumes responsibility for paying suppliers participating in the reverse factoring arrangement; and

(b) has permission from the entity to pay itself using amounts from the entity's bank account on the invoice due date.

33. Respondents say, in a few jurisdictions, the reverse factoring arrangements entered into legally novate the trade payable so that, on inclusion of an invoice in the arrangement, the payable is owed to the financial institution (rather than the supplier).

Arrangements enabling a supplier to receive payment earlier

34. Respondents say reverse factoring arrangements are most commonly set up to enable an entity's suppliers to receive payment for invoices earlier than the date on which payment is due.

35. Arrangements of this type:

(a) often require little input from the entity, other than to approve the invoices for payment by their inclusion on the platform. Once an invoice is uploaded to the platform, the financial institution may offer early payment to the supplier, or take advantage of early settlement discount the supplier has offered to the entity in the invoice.

(b) may offer the supplier the option of factoring the entity's payables on an invoice-by-invoice basis. In this case, the entity may be unaware of whether its payable for a particular invoice has been paid by the financial institution before the date it would otherwise be due.

36. In its simplest form, reverse factoring arrangements of this type do not extend the credit terms available to the entity from those agreed with the supplier, and typically do not change the other terms of the liability. The only change resulting from the arrangement is that the entity pays the financial institution, rather than the supplier, on the date the invoice is due.

37. However, respondents also note that in many cases an entity and its suppliers agree to extended credit terms—that apply to all invoices—at the same time as the entity sets up the reverse factoring arrangement. The entity may have been unable to obtain the extended credit terms if the arrangement were not put in place.

38. By entering into a reverse factoring arrangement, the financial institution takes on credit risk associated with the entity’s non-payment of the trade payable. Some respondents say financial institutions sometimes seek additional credit enhancements from the entity. For example, to enter into a reverse factoring arrangement, some financial institutions may require a guarantee from the entity’s parent company or another group company.

Arrangements enabling an entity to settle payments later

39. Respondents say in some cases an entity enters into a reverse factoring arrangement to enable settlement of trade payables later than it would under the credit terms agreed between the entity and its suppliers.
40. In such an arrangement, the financial institution typically pays the supplier no later than the date the trade payable was due under the agreement between the entity and the supplier. However, separately the entity and the financial institution agree a later payment date by which the entity is required to pay the financial institution. The length of any extension of credit terms depends on negotiations between the entity and the financial institution.

How do entities account for reverse factoring arrangements?

41. Outreach respondents say entities account for reverse factoring arrangements differently; many note that this may reflect the differing terms of each arrangement.
42. Respondents provided information about how an entity accounts for reverse factoring arrangements in:
- (a) its statement of financial position (paragraphs 43–48);
 - (b) its statement of cash flows (paragraphs 49–50); and
 - (c) its disclosures (paragraph 51).

Statement of financial position

43. Respondents say an entity entering into a reverse factoring arrangement first considers the requirements for derecognition of financial liabilities in paragraphs 3.3.1–3.3.2 of IFRS 9 *Financial Instruments*. Those paragraphs require an entity to derecognise a financial liability (or a part of it) when:
- (a) the liability is extinguished—that is, when the obligation specified in the contract is discharged or cancelled or expires; or
 - (b) there has been a substantial modification of the terms of the financial liability or a part of it.

Arrangements enabling a supplier to receive payment earlier

44. Respondents say, on entering into a reverse factoring arrangement, an entity typically does not derecognise its trade payables when it receives no extension of credit terms. This is because, in that situation, entities often conclude that their obligation is not extinguished and there is no substantial modification of trade payables. As mentioned in paragraph 35(b) of this paper, the entity might be unaware of whether, and when, the financial institution has paid the supplier before the invoice’s due date.
45. Entities consider a number of factors in determining whether there has been a substantial modification of a trade payable. For example:
- (a) whether the nature of the liability has changed—the liability is to pay for goods or services received from a supplier and often the nature of that liability does not change;
 - (b) whether the credit terms have changed—the entity is required to pay the amount of the invoice on the date it agreed to pay the supplier and, as noted above, often the credit terms do not change.
46. In some cases, entities derecognise trade payables and, instead, recognise other financial liabilities. Respondents say this is common when the reverse factoring arrangement legally novates the payable to the financial institution.
47. Some respondents note that reverse factoring arrangements are often designed to ensure the entity can continue to report the liability as a trade payable.

Arrangements enabling an entity to settle payments later

48. Respondents say entities typically—but do not always—reclassify trade payables as other financial liabilities when a reverse factoring arrangement allows the entity to pay its liability later than the invoice due date.

Statement of cash flows

49. Respondents say the classification of cash outflows on settlement of the liability typically follows the classification of the liability in the statement of financial position—ie:
- (a) if an entity classifies its liability as a trade payable, it typically classifies the cash outflow on settlement of that liability as an operating cash flow.
 - (b) if the entity classifies the liability as other financial liabilities, it typically classifies the cash outflow as a financing cash flow.
50. If an entity classifies the cash outflow as a financing cash flow, it will report lower operating cash outflows than an entity not using a reverse factoring arrangement. This can make it difficult for users of the entity’s financial statements to determine the cash flow effect of purchasing goods and services in the ordinary course of business. Respondents say entities classifying the cash outflow from settling the liability as a financing cash flow typically either:
- (a) disclose a non-cash transaction at the time of entering into the reverse factoring arrangement applying paragraph 43 of IAS 7 *Statement of Cash Flows*; or
 - (b) ‘gross up’ the cash flows in the reverse factoring arrangement. In other words, the entity presents (i) a cash outflow from operating activities and a cash inflow from financing activities when the invoice is factored by the financial institution; and (ii) a cash outflow from financing activities when the entity settles the liability.

Disclosure

51. Respondents say entities often do not disclose the existence of reverse factoring arrangements. Entities presenting amounts owed under reverse factoring arrangements as other financial liabilities disclose information more frequently than those presenting amounts owed as trade payables. Some respondents say those entities disclosing information about reverse factoring arrangements often do so as a result of disclosure requirements (for example, those about liquidity risk) in IFRS 7 *Financial Instruments: Disclosures*.

Question for the Committee

Does the Committee have any questions or comments on the information provided in this paper?

Appendix A—submission

A1. We have reproduced the submission below:

31 January 2020

IFRS Interpretations Committee
IFRS Foundation
Columbus Building
7 Westferry Circus
London E14 4HD

By Electronic Mail: ifric@ifrs.org

Dear Members of the IFRS Interpretations Committee,

**CLASSIFICATION AND DISCLOSURE OF LIABILITIES AND LIQUIDITY RISKS
ARISING FROM SUPPLY CHAIN FINANCING ARRANGEMENTS**

Moody's Investors Service (MIS) appreciates the opportunity to provide the International Financial Reporting Standards Interpretations Committee (the Interpretations Committee) with our observations on current practices in the classification and disclosure of liabilities and liquidity risks arising from supply chain financing (SCF) arrangements such as reverse factoring (RF). In our experience, the use of SCF arrangements, including RF, is widespread, but disclosure of the practice is not. In fact, as highlighted in recent MIS research,¹ fewer than 5% of the entities rated by MIS are actually disclosing usage together with the impact on their financial statements and risk profile.² This raises three concerns:

- **First, without adequate disclosure it is difficult for users of financial statements to compare companies using SCF with those that do not.** SCF itself takes many forms, and the consequences of RF may be different to other tools such as dynamic discounting. Disclosure of the nature of these liabilities is important to ensure all users of financial statements can transparently and consistently assess the nature of the company's aggregate debt-like liabilities.
- **Second, SCF arrangements obscure the nature of debt-like liabilities.** The purpose of SCF products, including RF, is deliberately to distort the natural working capital equilibrium between supplier and customer because it enables earlier payment to the supplier and later payment by the customer. The funding gap is bridged by a bank or

¹ [“Non-financial companies – Global: Reverse factoring is increasingly popular but can weaken liquidity at a time of stress.” Moody's Investors Service, 19 September 2019.](#)

² “SCF Barometer 2018/2019,” PwC & Supply Chain Finance Community.

other funding provider. We are aware that some RF-providing banks will add together RF facilities with conventional debt facilities to calculate aggregate corporate exposure limits. Without consistent disclosure, stakeholders such as credit rating agencies cannot effectively evaluate aggregate leverage, and bondholders could potentially be frustrated in their ability to set and manage debt covenants effectively and consistently.

- **Third, default risk is obfuscated without adequate disclosure.** The lack of disclosure blurs the important distinction between operating and financing cashflows, and the risk of RF facilities falling away can materially increase default risk.

MIS requests that the Interpretations Committee consider providing guidance on:

1. **Disclosure** – the appropriate disclosure in the financial statements of a company when SCF arrangements are used; and
2. **Classification** – whether the process of overlaying an irrevocable payment undertaking over a simple trade invoice has the effect of transforming that invoice into a different obligation that should be disclosed separately from trade payables.

In the attached Annexes, we address these concerns in further detail (Annex I) and provide reasons for the Interpretations Committee to address the issue (Annex II).

We trust that the information provided in our letter is clear but please do not hesitate to contact us should you wish to discuss the submission or any aspect of it in further detail.

Yours faithfully,

/S/ **Philip Robinson**

Philip Robinson
Vice President – Senior Credit Officer
Corporate Finance

I. Background

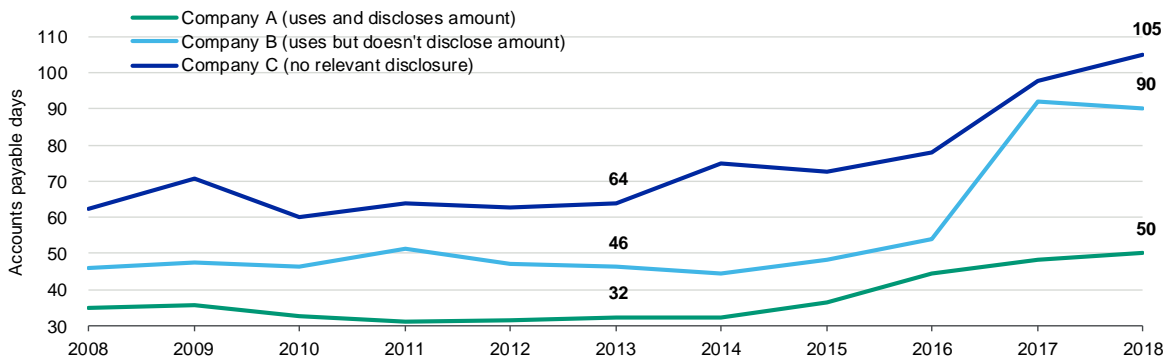
For every sector and company there is a natural equilibrium to working capital, though that equilibrium is not the same for every sector or company. It can fluctuate as a function of financial policy, credit quality and other factors. However, many forms of SCF distort the natural working capital equilibrium by introducing a gap between the point at which payment is made to the supplier versus the later point at which payment is made by the customer. This gap is bridged by financing, and such financing should be accurately disclosed so that it is transparent to all users of a company's financial statements.

There are multiple perspectives from which such improved disclosure is required:

- **Leverage, coverage and covenants.** Many stakeholders use company financial statements to assess debt leverage or coverage levels. Different stakeholders may choose to take a wider or narrower definition of leverage, including or excluding elements such as lease financing alongside pure financial debt obligations. Different stakeholders may validly prefer different definitions to suit their varying requirements and comprehensive disclosure by the company would allow them to make an informed and accurate assessment. At present there is a risk that debt leverage and coverage covenants designed to measure and limit aggregate indebtedness may be frustrated by the lack of disclosure and potential omission of SCF liabilities.
- **Different types of SCF.** SCF is an umbrella label for a range of financing techniques, including RF and dynamic discounting. Improved disclosure about the use of different SCF tools would allow stakeholders to assess their differentiated impacts and risks, and whether the product is being used to extend payment terms beyond those that the supplier would accept in the absence of the facility.
- **Asymmetric disclosure.** At present if SCF usage and obligations are not disclosed, it appears that banks and other funding providers who provide SCF facilities, while at the same time participating in a company's core financing facilities, are better sighted on the company's aggregate funding requirements than other debt creditors such as bondholders who may primarily rely on reported information. Such a situation may favour SCF providers and allow such banks quickly to reduce exposure to the company if stress starts to crystallise, while other creditors may be disadvantaged. That asymmetric disclosure creates scope for unexpectedly asymmetrical losses for bondholders. While it may economically favour the bank in the short term, there is scope for broader reputational damage to the bank as well to the extent they knowingly leveraged asymmetrical information to their advantage. Both these issues could be mitigated through comprehensive disclosure in advance.
- **Impact of irrevocable payment undertakings (IPUs).** We are aware that in some cases, before advancing early payment to a supplier, SCF providers may require that the

customer provides an IPU in respect of the underlying invoice. By design that transforms a trade payable obligation – which might normally be disputed on the grounds of non-delivery or quality of goods and services provided, and has no absolute specific payment date – into a more certain and readily ‘monetisable’ asset whereby the right to challenge is waived and payment is undertaken to be made at a specific date. The benefits to the SCF provider are clear in that payment by the customer is now more certain than for a normal trade payable. We seek clarity on whether the process of overlaying an IPU on top of a simple trade invoice has the effect of transforming that invoice into a different obligation that should be disclosed separately from trade payables.

- Consistency.** Specifically, we do not assert that SCF is ‘a bad product’ or that companies that use it should in some way be penalised. However, in rank ordering the credit quality of around 5,500 rated non-financial corporates, it is a challenge if disclosure is inconsistent. Consistent and transparent disclosure would aid our objective to accurately rank companies based on their credit quality. The chart below illustrates the evolution in the accounts payable days metric over the last three years for three companies in EMEA. The metrics all show a similar pattern, i.e. a multi-year trend at a consistent level followed by a marked increase, especially in the last two to three years. Company A discloses use of RF and the actual amount; Company B discloses use of SCF but not the amount; Company C does not explain the increase in its financial statements. To reiterate, we make no criticism of Company A or Company B for using SCF, nor of Company C for not disclosing (and without disclosure, we cannot reliably tell whether the rise is attributable to SCF or some other reason).



In our September 2019 [report](#) “Non-financial companies – Global: Reverse factoring is increasingly popular but can weaken liquidity at a time of stress”, we highlighted the disclosure by Wm Morrison Supermarkets plc, disclosing usage, facility size and, that its liquidity policy was calibrated to ensure liquidity headroom even based on the conservative planning assumption that SCF facilities were no longer available. It is an example that we found helpful in addressing some of the transparency concerns highlighted in this letter and assisted with our understanding of the company’s credit profile.

Reasons for the Interpretations Committee to Address the MIS Request

a. Is the issue widespread and has, or is expected to have, a material effect on those affected?

Yes. According to a recent report from the Supply Chain Finance Community and PwC,³ more than 50% of companies are using SCF, however, fewer than 5% of the entities rated by MIS are disclosing usage together with the impact on their financial statements and risk profile (as highlighted in our September 2019 [report](#) “Non-financial companies – Global: Reverse factoring is increasingly popular but can weaken liquidity at a time of stress”).

SCF facilities have the potential to have very material impacts on companies, where:

- trade terms have been extended but the liabilities remain classified as trade payables without further disclosure; or
- facilities are withdrawn in times of stress, creating further pressure on liquidity.

b. Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?

Yes. At present it is challenging to compare companies that do not disclose the existence and usage of SCF facilities. Liabilities may be included on the balance sheet under the caption ‘trade payables’ without identification of the fact that these may be due to a single obligor under a SCF facility, and the terms of these payables may be different to those the supplier would accept in the absence of such a facility. In cases where the company has chosen to identify these liabilities as a separate line item, there can be inconsistencies in the cash flow statement, where payment of the obligation is treated as a financing cash outflow rather than operating. However, if the existence of the facility is known, and the disclosure is clear, we are able to factor this into our analysis.

SCF is a broad label which encompasses many different underlying tools. For example, the consequences of RF and dynamic discounting may be very different, but without sufficient disclosure these differences cannot be assessed.

c. Can the issue be resolved efficiently within the confines of IFRS and the Conceptual Framework for Financial Reporting?

Yes. We believe guidance already exists in International Financial Reporting Standards (IFRS), in paragraphs 3.3.1 and 3.3.2 of IFRS 9, paragraphs 58 and 122 of International Accounting Standard (IAS) 1, and paragraphs 14, 17 and 43 of IAS 7.

³ “SCF Barometer 2018/2019,” PwC & Supply Chain Finance Community.

- d. Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process?**

Yes. It is only concerned with the interpretation of the paragraphs mentioned in c above.

- e. Will the solution be developed by the Interpretations Committee be effective for a reasonable period of time?**

Yes. We are not aware of any current or planned International Accounting Standards Board project on SCF.