May 2023

Investor Perspectives

Supplier finance: new disclosure requirements to aid investors

Zach Gast

Investors need to know more about the effect of supplier finance arrangements on companies—leading the International Accounting Standards Board (IASB) to issue new disclosure requirements.

IASB member **Zach Gast** explains what companies need to do and how investors helped shape the new requirements.

Executive Summary

The IASB recently issued *Supplier Finance Arrangements*, which introduces new disclosure requirements for this rapidly-growing area of working capital finance (sometimes referred to as reverse factoring). Companies are required to provide the new disclosures for the first time for annual reporting periods beginning on or after 1 January 2024.

The new disclosures will bring transparency into where payables associated with supplier finance arrangements sit on the balance sheet and allow investors to make their own determination of how they thus affect cash flows. For background information on the project, see the Investor Perspectives article *Supplier Finance Arrangements—disclosures that reflect investor needs*.

> "The new disclosures will bring transparency into where payables associated with supplier finance arrangements sit on the balance sheet…"

What are the new disclosure requirements?

In developing the disclosure requirements, the IASB sought input from a range of investors. Those investors said that supplier finance arrangements have the most significant effects on a company in terms of liabilities, cash flows and liquidity risk. The IASB therefore developed a package of disclosure requirements—explained and illustrated below—to enable investors to assess these types of effects of supplier finance arrangements on a company. A company might decide to disclose the information in a different format to that shown.

IFRS Accounting

Note X—Supplier Finance Arrangements

The entity entered into arrangements with the following terms and conditions:

- Type A...
- Type B...

Carrying amount of liabilities	Reporting date 20X2	Reporting date 20X1
Presented within trade and other payables	CU1,500	CU1,000
– of which suppliers have received payment	CU1,050	CU800
Presented within finance payables	CU1,000	CU750
– of which suppliers have received payment	CU900	CU650
Range of payment due dates		
Liabilities that are part of the arrangement	85–90 days after invoice date	80–90 days after invoice date
Comparable trade payables that are not part of an arrangement	60–70 days after invoice date	60–65 days after invoice date

Non-cash changes

There were no material business combinations or foreign exchange differences in either period. There were non-cash transfers from trade payables to finance payables of CU1,200 and CU900 in 20X2 and 20X1.

Terms and conditions

A company applying the requirements would likely begin with disclosures of the terms and conditions of supplier finance arrangements. Those terms and conditions provide context for investors about how such programs are used and any constraints within the arrangement.

Amounts of liabilities

A company would provide quantitative information on any payables that were approved as part of the supplier finance arrangement, reconciling where they sit on the balance sheet, and breaking out any payables where the supplier had already taken payment from the third-party finance provider.

Ranges of payment due dates

A company is required to disclose the range of payment due dates for payables within the supplier finance arrangements and comparable payables (for example, in the same line of business or jurisdiction) outside those arrangements. A company would provide further explanation if the ranges of payment due dates are wide.

Non-cash changes

Under some supplier finance arrangements, trade payables retain their classification in a company's balance sheet after they are approved for inclusion in the arrangements. In other arrangements, there could be a change in classification—the trade payable could be derecognised and a new finance payable recognised. The feedback from investors suggested that knowing when this change in classification has occurred is essential in analysing both liabilities and cash flows. The change in classification could result in a non-cash transfer in the statement of cash flows: an operating cash inflow when the trade payable is initially created followed by a financing cash outflow when the new finance payable is paid. This non-cash transfer can have significant ramifications for investors' analysis of operating cash flows or free cash flows.

Liquidity risk information

A company is also required to provide liquidity risk information about its supplier finance arrangements. In their feedback to the IASB, investors said it is important for them to understand if a company's use of supplier finance arrangements has concentrated the company's liabilities with one or a few finance providers. If finance providers withdraw one or more arrangements during times of financial stress, which could occur at short notice, that withdrawal could increase pressure on the company's cash flows and affect its ability to settle liabilities when they are due.

Illustration of the non-cash transfer

<table>
<tr><th></th><th>Trade payable created</th><th>Trade payable derecognised and finance payable recognised</th><th>Finance payable paid</th></tr>
<tr><td>Balance sheet</td><td></td><td></td><td></td></tr>
<tr><td>Trade payable</td><td>+100</td><td>–100</td><td></td></tr>
<tr><td>Finance payable</td><td></td><td>+100</td><td>–100</td></tr>
<tr><td>Cash flow statement</td><td></td><td></td><td></td></tr>
<tr><td>Operating cash flows</td><td>+100</td><td rowspan="2">No cash flow recorded – a non-cash transfer</td><td></td></tr>
<tr><td>Financing cash flows</td><td></td><td>–100</td></tr>
</table>

When will the disclosures appear in financial statements?

The disclosures are mandatory for financial statements for fiscal years beginning on or after 1 January 2024. No disclosures are required in interim financial statements in the first year of application. Companies are also not required to report the opening amounts in the first year of application for payables for which suppliers have received payment from finance providers or for the ranges of payment due dates. To obtain this information, a company might need to change its systems or amend its contracts, which might be difficult to do by the date of initial application.

Why didn't the IASB change the accounting for supplier finance arrangements or require direct disclosure of its effects?

The IFRS Interpretations Committee (Committee) determined in a December 2020 agenda decision that IFRS Accounting Standards already provide an adequate basis for a company to account for supplier financing. One of the most important questions from investors that the Committee considered was: when does use of a supplier finance arrangement cause a company to derecognise a trade payable and recognise a new liability (finance payable)?

The Committee determined that IFRS Accounting Standards already provide requirements for when a company presents a financial liability as a trade payable and when it derecognises a trade payable and recognises a new finance payable. One of the conditions that must be met for a company to present a financial liability as a trade payable is that the payable must be part of the working capital used *in the company's normal operating cycle*.

In their feedback, some investors asked the IASB to add a requirement for a company to directly disclose the effects of supplier finance arrangements on the company's liabilities and cash flows. The IASB learned that investors have varying ways of calculating these effects, and if the IASB was to mandate disclosure of effects using any one method, that might leave other investors with information that is less useful. Therefore, the IASB decided to require companies to provide individual data points about their supplier finance arrangements to enable investors to calculate effects themselves, using their own methodologies.

Find out more

The full text of the amendments is available here [insert link]

To get in touch

Contact me at zgast@ifrs.org or Sid Kumar from the Investor Engagement team at skumar@ifrs.org.

Follow @IFRSFoundation on Twitter to keep up with changes in the world of IFRS Accounting Standards.