International Accounting Standards Board
Columbus Building
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25 January 2022

Dear Board Members,

Exposure Draft: Supplier Finance Arrangements

We agree there is a need to improve disclosure about supplier finance arrangements and that the proposed disclosures will help investors to understand and calculate the impact of these arrangements on liquidity, leverage and cash flow.

We have four suggestions:

Payment date disclosure

If payment dates are disclosed, we think these should be expressed as a weighted average rather than as a range. In addition, we think it should be clarified that payment dates for trade payables not included in a supply finance arrangement should be for similar liabilities.

Liability roll-forward

The proposed disclosures may not be sufficient in cases where liabilities are affected by business combinations, business disposals and exchange differences. Although disclosures about these effects should be forthcoming because of the disclosure objective, we suggest that this is made more explicit. In our view, the best way to achieve this is to require a liability roll-forward disclosure.

Complexity for investors

The calculations necessary for investors to determine the effect of supplier finance arrangements on operating cash flow are not trivial. Furthermore, the calculations differ depending on whether the liability is classified as trade payables or as bank debt by the reporting entity. While the disclosures may, in theory, give investors the necessary information, if the complexity means that most investors do not make the effort to do the appropriate calculations, the practical benefit for capital markets may be limited.

We suggest that significant simplification could be achieved if the effect of an arrangement on operating cash flow is directly provided, rather than giving investors the raw data and expecting them to do their own calculations.

Non-cash changes

We agree with the proposal to add supplier finance as an example of a non-cash change in financing liabilities in cases where the liability is classified as debt. However, we think some investors may not realise that there is, in effect, a related positive impact on operating cash flow. We suggest the Board consider how this could be made clearer.

Our answers to specific questions, including further elaboration on these suggestions, are given below.

Yours,

Steve Cooper and Dennis Jullens

The Footnotes Analyst is a blog for investors and analysts on financial reporting and equity analysis that is written by Steve Cooper and Dennis Jullens. Steve Cooper is a former IASB Board Member. Dennis Jullens is an academic and a member of the EFRAG Technical Expert Group. Both Steve and Dennis previously worked in investment banking, including as colleagues at UBS investment research.

Responses to 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.

We agree.

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:
 	
1. (a) the terms and conditions of each arrangement;
2. (b) for each arrangement, as at the beginning and end of the reporting period:
    1. (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;
    2. (ii) the carrying amount of financial liabilities disclosed under (i) for which suppliers have already received payment from the finance providers; and
    3. (iii) the range of payment due dates of financial liabilities disclosed under (i); and
3. (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.

We believe the proposed disclosures would enable investors to better understand the effect of supplier finance arrangements and facilitate adjustments to derive more relevant cash flow and leverage metrics. However, we have the following suggestions:

Payment due dates

We suggest that the requirement to disclose ranges of payment dates is changed to a requirement to disclose the weighted average payment date in each case. Investors will use the payment date information to adjust cash flow and, potentially, leverage metrics. For this calculation a single point estimate is required. The mid-point of the range could be used but, in some cases, this may not be representative of the average payment due dates and its use may distort the adjustments.

The range of payment dates for trade payables that are not part of the supplier arrangement should refer to similar liabilities. If a supplier finance arrangement is used in one part of a business or group, it would not be helpful for the range of payment dates for other trade payables not in the arrangement to be provided if they arise in a different business activity. If there are no similar trade payables outside the arrangement, it would be more useful for the entity to disclose the estimated average payment dates for that industry rather than provide irrelevant information for a different business activity within the same group.

Business transactions and exchange differences

In cases where business combinations, business disposals and exchange differences affect the supplier finance liability, the proposed disclosures may not be sufficient. Presumably this will be covered by the disclosure objective and additional data should be provided. However, we think that it would be preferable to make this explicit.

We think that the best way to achieve this is to require a roll-forward of the liability arising from supplier finance arrangements, with that roll forward analysed between the underlying trade payable component and the debt financing provided to the purchaser. Even better would be to simply provide the necessary cash flow information directly, as we explain below.

Simplifying the disclosures to help investors

Investors would like to understand the effect of supplier finance arrangements on operating cash flow and, consequently, on related cash flow metrics such as free cash flow. This applies, albeit with a different effect, when the liability is presented as a trade payable and when presented as a financing liability.

If the liability is presented as a trade payable, investors need to identify the change in the amount that exceeds the estimated payable had the arrangement not existed. However, if the liability is presented as a financing obligation, investors need to adjust operating cash flow for both the related non-cash change in financing that occurs when liabilities become part of the arrangement, and for the change in the trade payable component of the total obligation that is included in financing.

The proposed disclosures are sufficient to do this analysis (subject to our qualifications above). However, the calculations are not trivial, and we think will be challenging even for many sophisticated investors. *Understandability* is one of the enhancing qualitative characteristics specified in the IFRS Conceptual Framework. While individually each of the proposed disclosures may be understandable, we question whether, when taken as a whole, the proposal would produce understandable financial statements, at least for most investors.

In our view, if supplier finance arrangements have a material impact on operating cash flow, the entity should quantify the effect and tell investors the result rather than provide the 'raw data' and expect investors to calculate it for themselves.

Similar considerations apply to the effect on financial leverage. If, for example, a supplier finance arrangement liability that is presented as trade payables exceeds the amount that would have been payable without the arrangement in place, this excess 'borrowing' component should itself be disclosed, rather than the underlying data necessary to calculate it.

Furthermore, we note that the proposed disclosures are required even in cases where the arrangement is solely used for the purpose of facilitating finance and improved cash flow for an entity's suppliers, with no impact on that entity's own cash flow or leverage. In this case, we do not see the need to provide many of the disclosures. We suggest that a greater focus on the impact of the arrangement, rather than disclosure of raw data, would more likely result in no disclosure if the effects are not material.

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 agree.

Including supplier finance as a separate non-cash item in the reconciliation of changes in financing liabilities is very important, particularly as it is essential to understand the cash flow effects of arrangements classified as debt. However, investors may not realise the importance of this item when interpreting operating cash flow. We think there is a need for better reporting of this non-cash transaction, and other transactions, such as leases and stock-based compensation, that have similar offsetting flows affecting different subtotals in the cash flow statement. Our preference is to present such movements in a separate column adjacent to the cashflows. In effect this is a gross-up approach but presented separately from actual cash flows.

We recognise that wider reform of cash flow (and non-cash movements) is probably beyond the scope of this project. Nevertheless, the board could highlight the need for companies to provide transparency about the impact of supplier finance arrangements on operating cash flow. We also suggest the board prioritise further work on non-cash transactions that impact cash flow subtotals, either as a separate limited scope project or as part of a comprehensive review of the statement of cash flows.