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IFRS Developments

Supplier finance arrangements – new disclosure requirements

What you need to know

- In the amendments published in May 2023, the IASB introduces new disclosure requirements in IFRS Standards to enhance the transparency and, thus, the usefulness of the information provided by entities about supplier finance arrangements.
- The amendments will be effective for annual reporting periods beginning on or after 1 January 2024, with early application permitted.

Highlights

On 25 May 2023, the International Accounting Standards Board (the IASB or the Board) issued amendments to IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures*. The amendments were initiated as a result of the December 2020 agenda decision (the AD) by the IFRS Interpretations Committee (the IFRS IC or Committee), addressing the presentation of liabilities and the associated cash flows arising out of supplier finance arrangements, as well as disclosures required for such arrangements. In the process, the IFRS IC and the Board acknowledged that the current disclosure requirements might not meet users' information needs.

The amendments are based on those initially set out in Exposure Draft ED/2021/10 *Supplier Finance Arrangements* (the ED).

The current requirements

In the AD, the IFRS IC noted that IFRS 7 requires disclosures to enable users to evaluate the nature and extent of risks, including liquidity risk, arising from financial instruments. It also acknowledged that liquidity risk arises from entering into supplier finance arrangements due to liabilities being concentrated with one financial institution rather than with a diverse group of suppliers. Furthermore, the Committee noted that an entity may become reliant on the extended payment terms of such an arrangement, which, if it were to be subsequently withdrawn, could lead to an inability to settle liabilities when they are due to the suppliers.

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IAS 7 requires "disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes". The Committee noted that such disclosures are required for liabilities that are part of supplier finance arrangements if the cash flows for those liabilities were, or if future cash flows will be, classified as cash flows from financing activities.

The IFRS IC highlighted that an entity would need to apply judgement to determine whether additional disclosures are required to ensure that the effects of supplier finance arrangements are adequately disclosed, and it observed that, under IAS 1 *Presentation of Financial Statements*:

- Assessing how to present liabilities and cash flows related to supplier finance arrangements may involve judgement, which will require certain disclosures

  And

- Since supplier finance arrangements may have a material effect on an entity's financial statements, the entity should provide information about those arrangements to the extent that it is relevant to an understanding of its financial statements.

The disclosure requirements in the amendments enhance the current requirements and are intended to assist users of financial statements in understanding the effects of supplier finance arrangements on an entity's liabilities, cash flows and exposure to liquidity risk.

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Characteristics

The amendments clarify the characteristics of supplier finance arrangements. In these arrangements, one or more finance providers pay amounts an entity owes to its suppliers. The entity agrees to settle those amounts with the finance providers according to the terms and conditions of the arrangements, either at the same date or at a later date than that on which the finance providers pay the entity's suppliers. As a result, supplier finance arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the original payment due dates.

Different terms are used to describe these arrangements, such as supply chain finance, payables finance and reverse factoring arrangements. Arrangements that are solely credit enhancements for the entity, for example, financial guarantees including letters of credit used as guarantees, are not supplier finance arrangements. Similarly, instruments used to settle the amounts owed directly with a supplier, for example, credit cards, are not supplier finance arrangements.

Disclosure requirements

The amendments require an entity to provide information about the impact of supplier finance arrangements on liabilities and cash flows, including:

- Terms and conditions
- As at the beginning and end of the reporting period:
  - The carrying amounts of supplier finance arrangement financial liabilities and the line items in which those liabilities are presented
  - The carrying amounts of financial liabilities and the line items, for which the finance providers have already settled the corresponding trade payables

- – The range of payment due dates for financial liabilities owed to the finance providers and for comparable trade payables that are not part of those arrangements
- The type and effect of non-cash changes in the carrying amounts of supplier finance arrangement financial liabilities, which prevent the carrying amounts of the financial liabilities from being comparable

The amendments require an entity to aggregate information about its supplier finance arrangements. However, the entity must disaggregate information about unusual or unique terms and conditions of individual arrangements when they are dissimilar. Explanatory information about payment due dates, when those payment due date ranges are wide, must also be disaggregated.

In the context of quantitative liquidity risk disclosures in IFRS 7, supplier finance arrangements are included as an example of other factors that might be relevant to disclose.

Transition and effective date

The amendments will be effective for annual reporting periods beginning on or after 1 January 2024. Early adoption is permitted but will need to be disclosed.

The amendments provide some transition reliefs. For example, an entity is not required to disclose comparative information for any reporting periods presented before the beginning of the annual reporting period in which the amendments first apply. There is also a relief from providing some of the quantitative information disclosed at the beginning of the annual reporting period which the amendments first apply. Furthermore, the amendments clarify that entities are not required to provide disclosures according to the new requirements in any interim reporting period during the first annual reporting period in which those amendments apply.

How we see it

The amendments are particularly relevant and timely considering that supplier finance arrangements have become a more prevalent source of financing in many sectors across jurisdictions in recent years. However, the fact that the amendments do not attempt to define arrangements that are within the scope of the amendments can make their application more challenging and increases the amount of judgement that entities will have to apply.

In order to prepare for compliance with the new requirements, entities must consider if they need to improve their financial reporting systems and/or obtain legal permission from finance providers in order to collect the information that is required to provide the new disclosures. As a result, it is key that entities allow sufficient time to prepare for the implementation of the new disclosure requirements.

IAS 34 *Interim Reporting* has not been consquentially amended, and thus the new requirements in IAS 7 and IFRS 7 will not necessarily apply in the context of condensed interim financial statements. However, under IAS 34 judgement needs to be applied in order to ensure that information that is significant to an understanding of the changes since the end of the last annual reporting period is disclosed. Thus, entities may consider the new requirements in IAS 7 and IFRS 7 relevant for condensed interim financial statements too. The relief provided for interim reporting in the first annual reporting period in which the amendments apply may, in these cases, be helpful.

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