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## IASB / IFRS

# Exposure Draft Supplier Finance Arrangements

## Proposed amendments to IAS 7 and IFRS 7

*Submission deadline 28<sup>th</sup> March 2022*

To: IFRS

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### **Response from UKSA and ShareSoc**

#### **1. Introduction**

- 1.1. The UK Shareholders' Association (UKSA) and ShareSoc represent the voice of private investors in the UK. We are not-for-profit companies that represent and support shareholders who invest in the stock market. Between us we have over 22,000 members.
- 1.2. We welcome the IFRC's Exposure Draft on Supplier Finance Arrangements. We believe that current reporting requirements currently lack the necessary clarity and rigour to allow users of accounts to identify and understand the financial liabilities and risks that companies may be taking on when they adopt reverse-factoring as part of their procurement strategy.
- 1.3. We notice the comment in paragraph BC1 of the exposure draft that the Interpretations Committee considered a question from a credit rating agency about the information required to be provided in financial statements about supply chain finance (reverse factoring) arrangements. We assume that this refers to the letter of 31<sup>st</sup> January 2020 from Moody's Investors Service to the IFRS Interpretations Committee.

1.4. Moody's should be commended for raising its concerns about Supply Chain Finance (SCF) and for its clear and comprehensive analysis of the potential problems surrounding standards of reporting on SCF. Extensive and opaque use of SCF was an important factor in the demise of Carillion and the fact that so many investors and other stakeholders were taken by surprise. This fact notwithstanding, it was only the scandal around the failure of Greensill Capital in 2021 that created wide awareness of the actual and potential risks inherent in this type of financing.

1.5. In addition to the concerns set out by Moody's as a rating agency there are reasons why other stakeholders should worry about the use of SCF (reverse factoring) and its operational implications. These include:

1.5.1. SCF is, by any other name, a way of acquiring additional working capital for a business. Many businesses periodically require an increase in working capital and this can be funded via a number of conventional sources such as facilities provided by the company's bank. The need to use reverse factoring raises questions as to why such conventional sources of credit are not being used or, more pertinently, why they no longer appear to be available.

1.5.2. When a supplier enters into a supply arrangement with a customer the payment terms will be agreed (possibly by negotiation) and will form part of the supply contract. Customers that renege on these terms will be viewed with suspicion by suppliers. In cases in which a company pays late or very late the reaction from many suppliers will be to put the customer 'on stop' until outstanding invoices are settled in full. The resulting disruption to the supply chain and the customer's inability to obtain the goods and services it needs to carry on trading can easily pose an existential threat to the business. If it can no longer supply its own customers it is heading for failure.

1.5.3. The question has to be asked why, when conventional factoring services are already widely available, suppliers do not simply use these. Without any clear explanation or credible explanation from the buying entity one can only conclude that the discount applied to the invoices by the factoring agent is so high (due to the perceived credit risk of the buyer) that the suppliers balk at this. It is more attractive to them to take a tough line and put the buyer on stop. For the buyer in this situation, entering into SCF (reverse factoring) arrangements are potentially a way of delaying the day of reckoning.

1.5.4. As things stand, reverse factoring has been a convenient way of hiding and disguising these problems – as was seen with Carillion where approximately £0.5bn of debt apparently merited little more than a footnote in the notes to the financial statements.

1.5.5. It seems very likely that most forms of SCF are an expensive form of finance. The bank and or other funding providers will settle supplier invoices on the due date on behalf of the customer and will add a premium to the face value of the invoice when recovering their money from the customer. The cost of the premium is currently completely opaque in terms of reporting transparency.

1.5.6. There are a number of other important disclosure considerations which are discussed in the Annex to Moody's letter to the IFRS Interpretations Committee.

1.6. We are pleased and reassured that these issues are now being addressed by the IFRS. Our answers to the questions in the Exposure Draft are given below.

## **2. Answers to the IFRS's numbered 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.*

2.1.1 We understand and accept the Board's decision not to define 'supplier finance arrangements' but instead to describe the characteristics of arrangements which would be covered by the requirements set out in the Exposure Draft.

2.1.2 We feel that the description of the characteristics as set out in paragraph 44G is not entirely satisfactory. As it stands, 44G could include conventional factoring (which is not the intention). Paragraph

BC7 makes it clear that it is **the buyer** that is entering into an arrangement with the one or more finance providers to settle suppliers' invoices on a date before the buyer pays the amount it owes for the goods and services. **The buyer, therefore, is entering into a formal credit arrangement with the finance provider.** We would like to see this distinction stated with greater clarity in 44G.

2.1.3 BC7 helps to distinguish between SCF (reverse factoring) arrangements and, say, those in which a buyer arranges for a finance provider to offer conventional but slightly more advantageous factoring terms to suppliers (should they wish to use them) at no additional cost to the buyer and with no contractual obligation on the part of the buyer. Again, this distinction needs to be made clearer in 44G.

**Question 2: Disclosure objectives 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.*

- 2.2.1 We agree with the proposals as set out in the Exposure Draft. We do, however, note the suggestion that an entity should be able to aggregate information needed to meet its disclosure objectives for different arrangements when the terms and conditions of those arrangements are similar. It would be helpful if the IFRS could give an example of what ‘similar’ means in this context.

**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.*

- 3.2.1 We agree with this proposal. The rationale is well explained in paragraphs BC21 – 22 of the Exposure Draft.
- 3.2.2 In the context of quantitative liquidity risk disclosures (Appendix B of the Exposure Draft), we note that paragraph B11F states that Supplier Finance Arrangements are one of a number of ‘other factors’ that an entity ‘might consider in providing the disclosure required in paragraph 39C’. From an investor point of view this seems to create no obligation on boards to report on the implications for liquidity risk of SCF arrangements. It allows scope for boards to remain silent on the issue and, even when challenged, to claim that they ‘considered’ SCF arrangements but decided not to report on them and to do so without

providing any justification for their decision. We believe it would be better to amend the Exposure Draft to read: '*should* consider in providing the disclosure required in paragraph 39C'.

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