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Sue Lloyd
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom
E14 4HD

Dear Ms Lloyd

Tentative agenda decision – Supply Chain Financing Arrangements – Reverse Factoring

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the June 2020 IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on how to present liabilities to which reverse factoring arrangements relate and what information is required to be disclosed in relation to these arrangements in the financial statements.

We agree that the IFRS Interpretations Committee's conclusions regarding supply chain financing arrangements reflect the requirements of IFRS Standards.

We agree that the outcome of applying these requirements will lead to different presentations in the statement of financial position, within trade payables, other payables or in other financial liabilities depending on the terms of the arrangement and the relative similarity of the nature and function of the liability under the arrangement with more conventional trade payables. Whilst we agree with this outcome, we are concerned that users are not benefiting from a fuller understanding of these arrangements given the lack of specific disclosures required by IFRS 7. The Board may wish to consider adding to its agenda a project to improve disclosures in this area, potentially through illustrative examples, due to the increasing prevalence of alternative financing models such as these, and the move away from obtaining finance from a broad range of suppliers to a more concentrated approach with a single or small number of financial institutions or other funding vehicles. In particular, specific disclosures about the extent to which amounts are owed to parties other than the original supplier, irrespective of whether the amounts are included in trade or other payables, and the relative concentration of such amounts would provide users with information that currently is often not disclosed. Such disclosure would also counterbalance the fact that the term 'working capital', that is critical in determining whether a balance is a trade payable, is not defined.

Where an amount payable to an entity other than the supplier remains presented in trade and other payables, we would suggest additional disclosures including:

- a description of the entity's approach to presentation of the arrangement and the judgements made in applying the policy;
- the carrying amount of the liabilities and the line items in which they are presented;
- how the entity manages and monitors these arrangements including any impact on the viability of the business; and
- changes to the arrangement in the period, or subsequently, that would impact presentation or result in a change of liquidity risk.

Whilst we agree that the conclusion reached by the IFRS Interpretations Committee regarding the classification of cash flows is consistent with the requirements in IAS 7 Statement of Cash Flows, we note that the application of these requirements to factoring and reverse factoring arrangements may distort the determination of cash flows from operations. We therefore agree that disclosure of such non-cash movements will be important in understanding how the arrangement is accounted for. In a reverse factoring arrangement where the liability has been classified as a borrowing in the statement of financial position the Committee's approach will result in a single financing cash outflow in the cash flow statement without any corresponding financing inflow or operating outflow. This will reflect the treatment in the statement of financial position but not that in profit or loss where there will be an operating expense. We draw to the attention of the Committee that this issue is not unique to reverse factoring, but also applies to trade receivables factoring. When an entity does not derecognise trade receivables and the factor receives the cash directly from the customer, if the transferor only recognises a financing cash inflow from the failed sale borrowing from the factor, it will have no cash outflow for the repayment of the deemed borrowing nor any cash inflow from its customers even though it has recognised revenue as an operating item. Similar to our suggestion that the Board should consider the need for additional disclosures to support the presentation in the statement of financial position, we would suggest that the Board also considers the need for additional disclosure to help users understand the effect of factoring and reverse factoring transactions on the statement of cash flows. This could include consideration of whether the guidance in IAS 7.43-44 should be expanded, for example by including factoring and supplier financing arrangements as examples of when disclosures of non-cash transactions may be relevant.

In terms of the drafting of the tentative agenda decision we believe that the current wording reflecting the definition of a reverse factoring arrangement is too narrow as it is not always the case that the financial institution is paid at a date later than suppliers are paid. As such, we would suggest the following editorial change (underlined):

"In a reverse factoring arrangement, a financial institution agrees to pay amounts an entity owes to the entity's suppliers and the entity agrees to pay the financial institution ***<u>at the same or a later</u>*** *date than suppliers are paid."*

In addition to the liquidity risks mentioned in the tentative agenda decision, we would suggest an additional risk be mentioned which is that an entity may become reliant on the extended financing terms provided by reverse factoring arrangements to manage liquidity risk through the option to pay the financial institution later than it would have paid the supplier(s). If a financial institution were to withdraw the arrangement this could adversely affect the entity's ability to settle liabilities, particularly if the entity were already in financial difficulties.

Finally, we would suggest that clarification be added to the paragraph commencing *'Paragraphs 33-35 of IFRS 7 require...'* that this applies in all cases and is not dependent upon the presentation in the statement of financial position as trade payables, other payables or other financial liabilities.

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If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
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