Hong Kong Institute of
Certified Public Accountants
香港會計師公會

<u>Our Ref.: C/FRSC</u>

Sent electronically through the IASB Website (www.ifrs.org)

24 March 2022

Dr Andreas Barckow
International Accounting Standards Board
Columbus Building
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Canary Wharf
London E14 4HD
United Kingdom

Dear Andreas,

IASB Exposure Draft ED/2021/10
Supplier Finance Arrangements
(Proposed amendments to IAS 7 and IFRS 7)

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Exposure Draft (ED).

The HKICPA welcomes the IASB's proposals to enhance the transparency of supplier finance arrangements (SFA) and their effects on an entity's liabilities and cash flows.

We agree with the IASB's approach to describing the characteristics of SFA instead of defining SFA. However, we consider that the characteristics of SFA as stated in paragraph 44G of the ED may not be sufficiently clear. In particular, questions are raised as to whether the scope of SFA would depend on who initiated the financing arrangement, and the extent of involvement and cooperation between the buyer, the finance provider and the supplier. In this regard, we strongly recommend that the IASB provide a clear principle of what constitutes a SFA, test the characteristics of SFA to ensure they cover the arrangements that the IASB intends to cover, and provide illustrative examples that (i) fall within; and (ii) do not fall within the scope of the ED to explain the key features of SFA.

In addition, we note that neither the IFRS Interpretations Committee's Agenda Decision *Supply Chain Financing Arrangements-Reverse Factoring* nor the ED addresses the presentation of cash flows arising from SFA. It is likely that diversity in practice will continue to exist. We are concerned that the current proposal in paragraph 44B(da), which only requires disclosure of non-cash changes from financing activities, may not capture those that would be classified as cash flows from operating activities. Accordingly, we recommend that the IASB move the proposal in paragraph 44B(da) to paragraph 44H of the ED, and include disclosure of non-cash changes arising from operating activities. Also, consistent with our response to the IASB *Third Agenda Consultation*, we recommend the IASB consider undertaking a targeted project to improve the wider aspects of the statement of cash flows, including cash flows arising from SFA, in the future.

Our detailed comments are provided in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact me (ceciliakwei@hkicpa.org.hk), Katherine Leung (katherineleung@hkicpa.org.hk) or Norman Chan (normanchan@hkicpa.org.hk), Associate Directors of the Standard Setting Department.

Sincerely,

Cecilia Kwei
Director, Standard Setting Department

Work undertaken by HKICPA in forming its views

The HKICPA:

(i) issued an Invitation to Comment on ED/2021/10 on 29 November 2021 to its members and other stakeholders;

(ii) sought input from its Disclosure Initiative Advisory Panel and Financial Instruments Advisory Panel, which are mainly comprised of technical and industry experts from large as well as small and medium accounting firms (collectively, Practitioners);

(iii) sought input from a finance provider which is a listed company that engages in supply chain finance platform and commercial factoring in Mainland China; and

(iv) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder views. The Committee comprises preparer representatives from various industry sectors, regulators, as well as technical and industry experts from small, medium and large accounting firms.

Detailed comments on ED/2021/10

Question 1: Scope of disclosure requirements

1. The HKICPA and its respondents agreed with the IASB's approach to describing the characteristics of Supplier Finance Arrangements (SFA) that are within the scope of the proposals instead of defining SFA for the reason stated in paragraph BC6 of the ED. However, most of the respondents considered that the characteristics of SFA as stated in paragraph 44G of the ED may not be sufficiently clear.

2. Paragraph BC8(a) of the ED mentions that an arrangement whereby the reporting entity (the buyer) settles the invoices on their contractual due dates with the finance providers, but suppliers can choose to be paid earlier by the finance providers at a discount also falls into the scope of SFA. We consider that the substance of BC8(a) (i.e. the suppliers receiving early payment at a discount) could be similar to the following common financing arrangements, and so question whether these arrangements are within the scope of the ED.

    a) A supplier accepts a commercial bill issued by the reporting entity (the buyer) as settlement of the amount outstanding. The supplier may discount the bill with a bank and the buyer may or may not be involved in the discounting arrangement. A question arises as to whether and when such an arrangement would fall within the scope of SFA for the reporting entity. For example, does it depend on:
        i) whether the buyer or the supplier initiated the discounting *framework* arrangement?
        ii) whether the buyer was involved in negotiating the *granular details* of each discounting arrangement?
        iii) the extent of involvement/cooperation between the buyer and the bank that accepts the bills for discounting?

    b) Bank acceptance bills (BABs) are issued by a bank to the reporting entity (the buyer) which is then used by the buyer to settle the amount owing to a supplier. The supplier can choose to discount the BAB with the issuing or other bank earlier than the invoice due date, similar to the situation described in BC8(a) of the ED. As the issue of BABs involves cooperation between the buyer and the bank, a question arises as to whether trade payables that are subject to BAB arrangements fall within the scope of SFA.

    c) Equitable v. legal assignments. In certain equitable assignments, the suppliers would receive early payment from the finance providers but the buyers are not involved in and may not even know about the suppliers' financing arrangements. The following questions/concerns were raised by our respondents:
        i) As stated in paragraph 44G of the ED, one of the characteristics of SFA is that "the entity *agrees* to pay the finance providers". This seems to imply that equitable assignments of receivables may not fall within the scope of the ED. Our respondents questioned whether it is the IASB's intention that only legal assignment of

receivables (i.e. where there are tripartite agreements) would fall under the scope of the ED.

ii) If equitable assignments were to fall into the scope of the ED, then entities (the buyers) would have practical difficulties in obtaining and providing the information proposed in the ED, e.g. the disclosure of concentration risk as the reporting entity may not be in a position to know whether the financial liabilities under the SFA have been further assigned. Even if they could do so, there is a significant concern on the auditability of the related information.

3. We are concerned that if the characteristics of SFA are not clear, there would be a risk of inconsistent application of the proposals which would in turn reduce the comparability of financial information among entities.

4. A respondent noted that one of the major differences between reverse factoring and traditional factoring (where the supplier factors the receivable to a finance provider) is that reverse factoring is normally initiated by the buyer, not the supplier. Therefore, to address the questions raised in paragraph 2 above, this respondent suggested that the IASB consider adding this characteristic explicitly in paragraph 44G of the ED if this is the intention of the IASB.

5. In light of the above, the HKICPA strongly recommends the IASB:
   a) provide a clear principle of what constitutes a SFA. This would include the factors for consideration, e.g. the nature, timing and extent of involvement of the reporting entity in the arrangement, and an explanation of the key features of a SFA;
   b) test the characteristics of SFA to ensure that they cover the arrangements that the IASB intends to cover; and
   c) provide illustrative examples that (i) fall within; and (ii) do not fall within the scope of the ED with reference to the examples in paragraph 2 above.

Question 2: Disclosure objective and disclosure requirements

6. We generally support the proposed disclosures in paragraph 44F of the ED because we consider that they can provide useful information to users of financial statements to assess the effects of SFA on an entity's liabilities and cash flows.

7. A few respondents (practitioners) considered that the benefits of providing the disclosure in paragraph 44H(b)(ii) of the ED (i.e. the carrying amount of financial liabilities for which suppliers have already received payment from the finance providers) may not justify its costs. They considered that an entity would not normally obtain and verify such information in its daily operation. Therefore, the proposal would inevitably increase the costs of the entity to obtain and prepare, and the practical difficulties for the auditors to audit, such information. In addition, it is questionable whether the proposed disclosure helps users in assessing the financial position of the entity. In particular, for cases where the supplier receives early payment at a discount, the entity still has to pay the finance provider the full invoice amount on the due date (which would be disclosed under paragraph 44H(b)(iii) of the ED). The proposed disclosure in paragraph 44H(b)(ii) does not provide additional useful information in this case.

8. Given the above, the HKICPA recommends the IASB assess the costs and benefits of providing the proposed disclosure in paragraph 44H(b)(ii) of the ED by considering the feedback from users on the usefulness of such information, and from the preparers and auditors on the costs of preparing and auditing the proposed disclosure.

Question 3: Examples added to disclosure requirements

<u>*Concentrations of risk*</u>

9. We note that in certain financing arrangements, the finance providers may be acting as a conduit or an intermediary to spread the credit risk of the reporting entity to multiple finance providers (e.g. by sub-contracting all or part of the risk to other financial institutions). As the reporting entity may not know the finance provider's back-end arrangements on its debt, it may not be able to identify the ultimate finance providers in such case. It would only be able to identify the party with which it had contracted for the SFA and the total amount that it would have to pay to this party. We considered that the ED is not clear as to whether the proposal regarding concentrations of risk in paragraph IG18 would require an entity to disclose information only up to the party with whom it contracted or information that covers the whole chain of SFA. Accordingly, we suggest that the IASB clarify the extent of disclosure that is required under paragraph IG18 of the ED.

<u>*Statement of cash flows*</u>

10. Paragraph BC16 of the ED explains that SFA is added as an example to paragraph 44B of the ED to help users of financial statements understand the effects of SFA on an entity's <u>*operating*</u> and <u>*financing*</u> cash flows. However, the proposed disclosure in paragraph 44B(da) covers non-cash changes arising from financing activities only.

11. We note that neither the IFRS Interpretations Committee's Agenda Decision *Supply Chain Financing Arrangements-Reverse Factoring* nor the ED addresses the presentation of cash flows arising from SFA, e.g. whether the gross or net presentation of cash flows should be applied, and whether and when cash flows should be presented under operating or financing activities. Therefore, it is likely that diversity in practice will continue to exist. We are concerned that the current proposal in paragraph 44B(da) may not capture those non-cash changes that would be classified as cash outflows from operating activities in the future given the same facts and circumstances.

12. To capture all non-cash changes arising from SFA, we recommend that the IASB move the proposal in paragraph 44B(da) to paragraph 44H of the ED, and include non-cash changes arising from operating activities as follows:

    "non-cash changes arising from supplier finance arrangements (as described in paragraph 44G), for example when future cash outflows will be classified as cash flows from <u>operating or</u> financing activities~~; and~~"

    We consider that including this disclosure in paragraph 44H, which specifically addresses the disclosures of SFA, would avoid entities missing out the requirement that was originally proposed in other parts of IAS 7 *Statements of Cash Flows.*

13. In addition, as the issue on the presentation of cash flows arising from SFA is yet to be addressed, consistent with our response to the IASB *Third Agenda Consultation*, we suggest that the IASB consider undertaking a targeted project to improve the wider aspects of the statement of cash flows, including cash flows arising from SFA, in the future.

~ End ~