# Accounting for supply chain financing

Over the past three years, the IFRIC and IASB have considered various aspects of accounting for supply chain financing. This article outlines the accounting considerations and a recent amendment to IAS 7 and IFRS 7 relating to supplier finance arrangements.

The topic of supply chain financing ('SCF') has been on various IFRS Interpretations Committee ('IFRIC') and IASB agendas during the past three years. This article outlines some key accounting considerations regarding these arrangements and an amendment emerging from the process.

## What is supply chain financing?

When the IFRIC considered the prevalence and type of SCF transactions, they identified three common types of arrangements: reverse factoring, dynamic discounting and supplier inventory financing. They acknowledged early on in the project that the last likely involves considerations relevant to commodity-related transactions more broadly.

Reverse factoring is the most common SCF arrangement. The IFRIC focussed their attention on this. In brief, these arrangements involve three parties: a supplier of goods or services to an entity (supplier), the receiving entity (entity) and a financial institution. The arrangements may benefit the supplier, the entity or both. Essentially they involve the financial institution settling the invoice issued by the supplier (before or on the due date) and the entity paying the financial institution (on or after the invoice due date). The detailed terms of these arrangements vary in practice.

## What are the accounting questions?

The IFRIC agenda decision identified some accounting questions that arise when an entity enters SCF arrangements.

The first related to presenting the liability that the entity owed to the financial institution. Here, the questions are:

(a) Should this liability be presented as a 'trade and other payable' or another financial liability?

(b) Should it be presented separately?

IAS 1 provides guidance in this regard.

The second was whether an SCF arrangement results in the derecognition of the original payable and recognition of a new liability to the financial institution, either as a result of extinguishment or substantial modification of the original liability. The derecognition rules in IFRS 9 must be applied to the specific SCF.

Thirdly, there are differing views on how and when the arrangement should be reflected on the cash flow statement. These relate to both the timing when it is reflected (when the reverse factoring occurs or only when the liability to the financial institution is settled) and the classification of the cash flows.

Lastly, these arrangements impact disclosure about the entity's exposure to liquidity risks.

## Amendments to IAS 7 and IFRS 7

The IASB undertook narrow-scope standard-setting relating to SCF arrangements. This resulted in amendments to IAS 7 and IFRS 7 relating to supplier finance arrangements ('SFA').

IAS 7 describes SFAs as follows:

> 'Supplier finance arrangements are characterised by one or more finance providers offering to pay amounts an entity owes its suppliers and the entity agreeing to pay according to the terms and conditions of the arrangements at the same date as, or a date later than, suppliers are paid.'

The amendments introduce specific disclosure requirements relating to these arrangements. These disclosures aim to assist users in understanding their effect on the cash flow statement and an entity's liquidity risk.

Entities must apply the amendments for reporting periods beginning on or after 1 January 2024.

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