To the members of the IFRS Interpretations Committee (IFRIC)

Submitted electronically

Subject: Eumedion response to IFRIC's tentative agenda decision on Supply Chain Financing Arrangements

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The Hague, 30 September 2020

Dear members of IFRIC,

Eumedion appreciates the opportunity to respond to the IFRIC's tentative agenda decision on Supply Chain Financing (SCF) arrangements. Eumedion is the dedicated representative of the interests of 50 institutional investors, all committed to a long term investment horizon. Eumedion aims to promote good corporate governance and sustainability in the companies our participants invest in. We regard accounting standards as a critical part of a global financial infrastructure, especially since investors are dependent on the quality of accounting standards for allocating their own and entrusted capital. Together our participants invest over € 6 trillion of capital in equity and corporate non-equity instruments.

We are supportive of the tentative agenda decision. We observe rather infrequent disclosures on and separate presentations of SCF arrangements, while financial institutions do actively provide such services to listed entities. There is a risk that investors are often not informed of material SCF arrangements. Although this could well be an enforcement issue, we do expect that the tentative agenda decision will contribute to the proper application and enforcement of the Standards.

However, even with the agenda decision in place, an important characteristic of SCF liabilities for investors is likely to remain unreported. The economic substance of SCF liabilities will be interpreted by many investors as being partly in-substance payables and partly in-substance financial liabilities owed to a financial institution. This is especially true for SCF arrangements that increase the payment terms for the reporting entity. Doubling the payment term can be interpreted as a significant change in payment terms and thereby result in classification of the entire amount as an SCF financial liability. However, for many investors, halve of that amount would be regarded by many as an in-substance payable, and not an in-substance financial liability. If the payment terms for the reporting entity were 12 months, up from one month; only an approximate 8.3% (1/12th) of the reported SCF liability would be interpreted by many as an in-substance payable.

We therefore suggest that IFRIC complements its final agenda decision with a call on the IASB to introduce a requirement to disclose in the notes the actual net amount of credit that the financial institution provides to the reporting entity as a consequence of the SCF arrangement on the reporting date; i.e. the amount that the financial institution owes from the reporting entity under the SCF arrangement less the amount the financial institution owes to the suppliers of the reporting entity under the SCF arrangement on the reporting date.

A requirement to disclose this amount helps investors making several better assessments. Such requirement allows investors to continue to track how working capital requirements are developing over time. With an unknown part of the in-substance payables in financial liabilities, tracking working capital becomes either meaningless or requires time-consuming and likely quite inaccurate judgments.

From a valuation perspective, there is an intrinsic difference between a payable and a financial liability, even though both are liabilities. Payables contribute to a lower working capital. The lower or even the more negative working capital is, the less financial liabilities or equity an entity needs to finance its growth. Generally, the more the growth of the company can be financed by its suppliers, i.e. the more negative working capital is, the higher the market valuation of the equity such entity is. This argument reverses for financial liabilities: the more a company depends on financial liabilities to finance its growth, the lower the equity valuation of a company is. The suggested requirement allows for a more accurate valuation of a company.

There is also a liquidity dimension. Suppliers tend to be much more lenient towards their clients in their terms for providing credit, than financial institutions are. Unlike financial institutions, the margins of individual suppliers on the products and services sold generally provide a buffer against some debtors' inability to pay. Generally, listed entities don't go bankrupt because they fail to pay their suppliers, but because they fail to secure (re-)financing at financial institutions. If a financial institution cancels a supply chain finance arrangement, the milder short term consequence is that the entity will need to renegotiate new payment terms directly with its suppliers. It is likely that the payment terms that the suppliers agreed to through the original arrangement will be a starting point for such negotiations. The potentially major consequence is that the entity will need to repay or refinance the in-substance financial liability. The in-substance financial liability is the amount that resulted from the actual difference in the payment term of the entity to the financial institution and the payment term of the financial institution to the suppliers. So for liquidity and continuity assessments, a disclosure requirement that allows investors to calculate a split of the SCF liability in a payables and a financial liability is also relevant.

Without the requested disclosure requirement, many investors are likely to assume that all of the reported SCF liabilities are in-substance financial liabilities, which would in many cases be overly pessimistic.

If the members of IFRIC would like to discuss our views in further detail, please do not hesitate to contact us. Our contact person is Martijn Bos (martijn.bos@eumedion.nl, +31 70 2040 304).

Yours sincerely,

Rients Abma

Executive Director
Eumedion
Zuid Hollandlaan 7
2596 AL THE HAGUE
THE NETHERLANDS