Exposure Draft

Financial Reporting Council

September 2023

FRED 84

Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Supplier finance arrangements

The FRC's purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit and by holding to account those responsible for delivering them. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

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Contents

Overview

(i) The FRC's overriding objective in setting accounting standards is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

Draft amendments to FRS 102

(ii) 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. These arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date.

(iii) In the absence of specific disclosure requirements, users of financial statements may not receive sufficient information about an entity's use of supplier finance arrangements and the effect of such arrangements on the entity's financial position and cash flows.

(iv) The FRC received feedback from stakeholders that this topic should be addressed in FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* sooner rather than later. The FRC decided, before considering whether to propose similar amendments, to await the conclusion of the IASB's project to improve disclosures on this topic, which followed the IFRS Interpretations Committee considering a matter relating to supplier finance arrangements, on which an agenda decision was published in December 2020. This was discussed in paragraph A.34 of the Basis for Conclusions to FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review.*

(v) In May 2023, the IASB published *Supplier Finance Arrangements* (Amendments to IAS 7 and IFRS 7), which added disclosure requirements in respect of supplier finance arrangements to both IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures*.

(vi) The FRC has considered whether similar proposals are appropriate for FRS 102, particularly Section 7 *Statement of Cash Flows,* and has developed this FRED based on the amendments to IAS 7. No disclosure requirements based on those introduced into IFRS 7 are proposed as they relate to the requirements on liquidity risk, a topic which is not specifically addressed in FRS 102 other than for financial institutions.

(vii) Qualifying entities and small entities are not required to comply with the requirements of Section 7 of FRS 102 and so may not be impacted by the proposed amendments.

(viii) It is proposed that the amendments are effective for accounting periods beginning on or after 1 January 2025, with early application permitted.

Invitation to comment

1 The FRC is requesting comments on FRED 84 by 31 December 2023.

2 The FRC is committed to developing standards based on evidence from consultation with users, preparers and others. Comments are invited in writing on all aspects of the draft amendments. In particular, comments are sought in relation to the questions below.

Question 1

Do you agree with the introduction of the proposed disclosure requirements in relation to supplier finance arrangements into FRS 102? If not, why not?

Question 2

Do you believe that the disclosure required by sub-paragraph 7.20C(b)(ii) will provide useful information to users, proportionate to the cost and effort involved for preparers?

Question 3

Do you agree with the proposed effective date for these amendments? If not, what difficulties do you foresee?

Question 4

Do you have any comments on the consultation stage impact assessment, including those relating to assumptions, sources of relevant data, and the costs and benefits that have been identified and assessed? Please provide evidence to support your views.

In particular, feedback is invited on the assumptions about the prevalence of supplier finance arrangements amongst entities applying FRS 102.

3 Information on how to submit comments and the FRC's policy in relation to responses is set out on page 16.

Draft amendments to FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*

Draft amendments to Section 1
Scope

1 The following paragraph sets out the draft amendments to Section 1 *Scope* (inserted text is underlined).

2 A sub-heading and paragraphs 1.36 and 1.37 are inserted as follows:

<u>Supplier finance arrangements</u>

<u>1.36 In [month 2024] amendments were made to this FRS that introduce new disclosure requirements in respect of supplier finance arrangements. These amendments are effective for accounting periods beginning on or after 1 January 2025. Early application is permitted. If an entity applies these amendments early it shall disclose that fact, unless it is a small entity in the Republic of Ireland, in which case it is encouraged to disclose that fact.</u>

<u>1.37 In the reporting period in which an entity first applies these amendments, and in relation to these amendments only, an entity is not required to disclose:</u>

<u>(a) comparative information for the preceding reporting period; or</u>

<u>(b) the information otherwise required by sub-paragraphs 7.20C(b)(ii) to (iii) as at the beginning of the reporting period.</u>

Draft amendments to Section 7 *Statement of Cash Flows*

3 The following paragraph sets out the draft amendments to Section 7 *Statement of Cash Flows* (inserted text is underlined).

4 A heading (underlined) and paragraphs 7.20B and 7.20C are inserted as follows:

Supplier finance arrangements

7.20B 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. These arrangements provide the entity with extended payment terms, or the entity's suppliers with early payment terms, compared to the related invoice payment due date. Supplier finance arrangements are often referred to as supply chain finance, payables finance or reverse factoring arrangements. Arrangements that are solely credit enhancements for the entity (eg **financial guarantee contracts**) or instruments used to settle directly with a supplier the amounts owed (eg credit cards) are not supplier finance arrangements.

7.20C An entity shall disclose in aggregate for its supplier finance arrangements:

(a) the terms and conditions of the arrangements (eg extended payment terms and security or guarantees provided). However, an entity shall disclose separately the terms and conditions of arrangements that have dissimilar terms and conditions;

(b) as at the beginning and end of the reporting period:

(i) the **carrying amounts** and associated line items presented in the entity's statement of financial position of the **financial liabilities** that are part of a supplier finance arrangement;

(ii) the carrying amounts, and associated line items, of the financial liabilities disclosed under sub-paragraph (i) for which suppliers have already received payment from the finance providers; and

(iii) the range of payment due dates (eg 30–40 days after the invoice date) for both the financial liabilities disclosed under sub-paragraph (i) and comparable trade payables that are not part of a supplier finance arrangement. Comparable trade payables are, for example, trade payables within the same line of business or jurisdiction as the financial liabilities disclosed under sub-paragraph (i). If ranges of payment due dates are wide, an entity shall disclose explanatory information about those ranges or disclose additional ranges (eg stratified ranges); and

(c) the type and effect of non-cash changes in the carrying amounts of the financial liabilities disclosed under sub-paragraph (b)(i). Examples of non-cash changes include the effect of **business combinations**, exchange differences or other transactions that do not require the use of cash or cash equivalents (see paragraph 7.18).

Basis for Conclusions
FRED 84 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Supplier finance arrangements*

This Basis for Conclusions accompanies, but is not part of, this FRED and summarises the main issues considered by the FRC in developing FRED 84 Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland – Supplier finance arrangements.

When these proposals are finalised, the Basis for Conclusions accompanying FRS 102 will be updated.

Objective

1 In developing financial reporting standards, the overriding objective of the FRC is to enable users of accounts to receive high-quality understandable financial reporting proportionate to the size and complexity of the entity and users' information needs.

2 In achieving this objective, the FRC aims to provide succinct financial reporting standards that:

(a) have consistency with global accounting standards through the application of an IFRS-based solution unless an alternative clearly better meets the overriding objective;

(b) balance improvement, through reflecting up-to-date thinking and developments in the way businesses operate and the transactions they undertake, with stability;

(c) balance consistent principles for accounting by all UK and Republic of Ireland entities with proportionate and practical solutions, based on size, complexity, public interest and users' information needs;

(d) promote efficiency within groups; and

(e) are cost-effective to apply.

Background

3 The FRC understands that the use of supplier finance arrangements has increased in recent years, and they are more common amongst large entities, which may apply either IFRS Accounting Standards or FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. Such arrangements typically involve an entity using a finance provider to settle amounts it owes to suppliers, and settling with the finance provider at a later date. They may therefore offer extended payment terms for the entity, early payment for the supplier, or both.

4 Neither IFRS Accounting Standards nor FRS 102 previously contained specific requirements in respect of such arrangements. The FRC understands that this has resulted in diversity in practice for methods of presenting and disclosing the usage of these arrangements, which can act as an obstacle to users' understanding of, for example, a company's indebtedness and its credit risk.

5 The IFRS Interpretations Committee received a submission in January 2020 asking how entities should classify rights and obligations relating to supplier finance arrangements, and what disclosures are required. In December 2020, an agenda decision[1] was issued addressing how IFRS Accounting Standards should be interpreted in order to present the requisite information about supplier finance arrangements in a set of financial statements.

6 Subsequently, the IASB commenced a narrow-scope standard-setting project on supplier finance arrangements, and in November 2021, it published its Exposure Draft *Supplier Finance Arrangements*[2] (IASB/ED/2021/10), which proposed amendments to IAS 7 *Statement of Cash Flows* and IFRS 7 *Financial Instruments: Disclosures* setting out disclosure requirements in respect of supplier finance arrangements. Following revisions to reflect consultation feedback, the final amendments[3] were published in May 2023 with an effective date of 1 January 2024.

7 The FRC considered whether to reflect the proposals in IASB/ED/2021/10 within FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review*, but decided to wait until after the publication of the IASB's final amendments. This was discussed in paragraph A.34 of the Basis for Conclusions to FRED 82.

Proposed amendments to FRS 102

Statement of cash flows

8 In reviewing the IASB's amendments on this topic, the FRC considered whether the disclosure requirements are proportionate to the size and complexity of entities applying FRS 102, and users' information needs.

9 The FRC agrees with the IASB that the new disclosures should be presented alongside other information on the statement of cash flows since supplier finance arrangements are similar in nature to other forms of finance already covered by the statement of cash flows, and is proposing amendments to Section 7 *Statement of Cash Flows* that are based on the amendments to IAS 7.

10 Not all entities applying FRS 102 are required to present a cash flow statement, but for those that are, and enter into supplier finance arrangements, these disclosure requirements are expected to provide relevant information to users, improving the information available.

11 By its nature, the requirement to disclose the amounts settled with suppliers by the finance provider is not information that is necessarily available to the entity using the arrangements, since it is a transaction between third parties. Provision of this disclosure is therefore expected to require additional effort by the preparer in order to obtain the required data. The FRC has proposed to require this disclosure, based on a preliminary understanding that the costs to preparers should not be prohibitive and that the information is valuable to users.

Liquidity risk

12 The IASB's amendments to IFRS 7 include the addition of implementation guidance on how concentrations of liquidity risk may arise in the context of supplier finance arrangements. There are no changes to the body of IFRS 7 itself.

13 Paragraph 11.42 of FRS 102 requires disclosure of information on the risks to which an entity is exposed in relation to its financial instruments. This should include concentration of liquidity risk, when relevant, and therefore no amendments to FRS 102 are required in this regard.

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1 https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/2020/supply-chain-financing-arrangements-reverse-factoring-december-2020.pdf
2 https://www.ifrs.org/content/dam/ifrs/project/supplier-finance-arrangements/ed-2021-10-sfa.pdf
3 https://www.ifrs.org/content/dam/ifrs/publications/amendments/english/2023/iasb-2023-1-sfa-ias7-ifrs7.pdf

Effective date and transition

14 The proposed effective date is reporting periods beginning on or after 1 January 2025, as the expectation is that entities should not need a significant amount of time to prepare the required information. An entity will be permitted to early adopt.

15 Relief from providing comparative information in the first year of adoption is also proposed, including in respect of the opening balance information for the amounts for which suppliers have received payments and the range of due dates.

16 In finalising these amendments and the amendments proposed by FRED 82 the FRC will ensure that the paragraph numbers in Section 1 are unique.

Consultation stage impact assessment

Introduction

1 The FRC is committed to a proportionate approach to the use of its powers, making effective use of impact assessments and having regard to the impact of regulation on small enterprises.

Draft amendments to FRS 102

2 The proposals in this FRED will affect entities applying FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* that utilise supplier finance arrangements in scope of the amendments to settle their liabilities, and that are required to present a statement of cash flows.

3 Entities employing accountants will be impacted through the time spent by those accountants to familiarise themselves with the new requirements, in order to maintain their awareness of accounting requirements or to apply them in their work.

4 The proposals will also affect auditors of the financial statements of affected entities. In addition to familiarisation by individual auditors (who are also expected to be individual accountants), those firms or individuals may need to design new audit and assurance processes that address the proposed new disclosure requirements. This could lead to additional audit work and result in additional audit costs to the entities affected. We consider this to be a direct impact of the measures considered, which will fall on those entities required to apply the amended standards.

5 Users of financial statements will benefit from improvements to the quality of financial reporting of the affected entities.

Estimated number of entities in scope

6 In order to estimate the direct cost of compliance arising from our proposed amendments, we need to estimate the number of entities that would be affected by the proposals. Not all entities applying FRS 102 will utilise supplier finance arrangements and some of those that do may be exempt from presenting a statement of cash flows.

7 The impact assessment within FRED 82 *Draft amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review* set out calculations and assumptions for the estimated number of entities applying FRS 102 in the UK and the Republic of Ireland, which have been used as a basis for this impact assessment.

8 Small entities are not required to prepare a statement of cash flows and so will not be required to apply the proposed amendments. Further calculations have been made to estimate the number of large and medium-sized entities that are qualifying entities, which are also exempt from the requirement to prepare a statement of cash flows in their individual financial statements.

9 We estimate that 40% of medium-sized entities and 50% of large entities are subsidiaries. We have used the number of subsidiaries as a proxy for the number of medium-sized and large entities exempt from the requirement to prepare a statement of cash flows. This makes the simplifying assumption that all subsidiaries are qualifying entities taking advantage of the option not to present a cash flow statement. It also assumes that qualifying entities which are not subsidiaries (ie parent companies) will be

impacted by the proposals: although such companies are exempt from preparing an individual statement of cash flows, they would still need to prepare a consolidated statement of cash flows.

10 The following table sets out the estimated number of entities required to present a statement of cash flows, and associated disclosures, by size band:

Entity size	UK[4]	Ireland[5]	Total	Proportion that are not subsidiaries	Total that are not subsidiaries
Medium	30,696	2,792	33,488	60%	20,093
Large	6,597	874	7,471	50%	3,736

11 The following table is based on data collected[6] by the Department for Business and Trade (formerly the Department for Business, Energy & Industrial Strategy) on payment practices showing that, taking a five-year average, from 2019 to 2023, 7.2% of large companies self-reported their use of supplier finance arrangements.

	2019	2020	2021	2022	2023	Mean
Number of entities	7,538	6,969	6,712	6,463	6,080	
Prevalence of supply chain finance	6.7%	7.0%	7.3%	7.7%	7.4%	7.2%

12 Stakeholders have told us that these arrangements are predominantly used by large entities, so for medium-sized companies we have assumed that the prevalence of supplier finance arrangements is 10% of that for large companies, ie 0.72%. We have assumed that the prevalence of supplier finance arrangements in the Republic of Ireland is the same as in the UK. We further assume that companies that have these arrangements will only have one such arrangement rather than many.

13 The following table sets out, of the "in scope" number of medium-sized and large entities that are not subsidiaries, and are therefore expected to present a statement of cash flows, the estimated number of entities which have supplier finance arrangements and hence are affected by the proposed requirements:

Entity size	In scope	Proportion with supplier finance arrangements	Number with supplier finance arrangements
Medium	20,093	0.72%	145
Large	3,736	7.2%	269
Total			**414**

4 https://www.frc.org.uk/consultation-list/2022/fred-82 – Impact assessment paragraph 56 (page 296)
5 https://www.frc.org.uk/consultation-list/2022/fred-82 – Impact assessment paragraph 65 (page 298)
6 https://check-payment-practices.service.gov.uk/export

Estimated familiarisation costs for accountants

14 The proposed amendments are concise and should not require significant time to understand, especially as accountants dealing with these arrangements should already be familiar with their general operation. The amendments are also only likely to be relevant to the subset of accountants dealing with financial reporting, and of specific interest only to those accountants who work for entities impacted by the amendments. Therefore we assume that the associated familiarisation costs are part of the general Continuous Professional Development activities that accountants must undertake, and incur no substantive incremental cost.

Estimated one-off costs for preparers

15 We assume, once individual accountants have familiarised themselves with the new requirements, that for each affected entity, five hours of staff time will be required to analyse the terms and conditions of the entity's supplier finance arrangements, and establish the impact on the financial statements of the new disclosure requirements and how the information for the disclosures will be obtained. This includes preparing a template disclosure and the explanatory part of the note to include in the financial statements. We assume, for each affected entity, a further five hours to discuss with their finance providers the requirement for information on amounts paid to suppliers and establish how this will be fulfilled.

Estimated annual costs for preparers

16 We make the following assumptions about the amount of time involved in the preparation of the proposed disclosures on an ongoing basis:

(a) No substantive incremental time required for disclosure of carrying amounts and non-cash changes in carrying amounts, as this information should already be prepared as part of the process of preparing the statement of cash flows.

(b) No substantive incremental time needed for preparing the disclosure of the terms and conditions each year.

(c) For the disclosure of amounts paid to suppliers we assume one hour to request information from the provider and review and process the data received.

(d) We assume four hours for the preparation of the disclosure of date ranges, as this requires data to be sourced, calculations to be performed and reviews to be done.

17 We assume zero additional costs in respect of new systems and processes, since an entity using supplier finance arrangements should already have in place the systems and processes for their own financial reporting; the proposed amendments should not, except for the data needed from finance providers, require entities to obtain incremental data.

Estimated one-off costs for auditors

18 Auditors will need to update their audit procedures and financial statements checklists in respect of the new disclosure requirements. We assume that all audit firms will need to do this, regardless of whether they currently audit entities with supplier finance arrangements. Audit firms without prior experience of the amendments to IAS 7 *Statement of Cash Flows* will need to plan and implement new procedures to address the new requirements; firms which have already made similar changes in respect of the IAS 7 amendments will be able to utilise the new procedures developed for that purpose, reducing the effort needed. We assume four hours of effort for each audit firm without prior experience of the IAS 7 amendments and two hours of effort for each audit firm with that experience.

19 For the purposes of this calculation we have used data on the number of auditors used in the impact assessment for FRED 82, with smaller auditors as a proxy for those without prior experience of the IAS 7 amendments and larger auditors as a proxy for those with that experience (that is, those with experience of auditing entities that apply IFRS Accounting Standards).

Estimated annual costs of audit

20 For ongoing costs, we have assumed that the effort of auditing the new disclosures is equal to that of preparing them. Since the supplier finance arrangements already exist then auditors should already be familiar with the arrangements and their terms and conditions, and the incremental effort is only in auditing the new required disclosures.

Total costs

21 The table below sets out the calculation of the total one-off preparer costs expected in respect of the proposed amendments:

Entity size	Entities	One-off hours per entity	Cost per hour, £[7]	One-off costs, £
Medium	145	10	35.70	51,765
Large	269	10	35.70	96,033
Total	**414**			**147,798**

22 The table below sets out the total one-off costs for UK auditors:

Auditor size	Number of audit firms[8]	Hours per firm	Total hours	Cost per hour, £	Total costs, £
Smaller	4,187	4	16,748	35.70	597,904
Larger	123	2	246	35.70	8,782
Total	**4,310**				**606,686**

23 The table below sets out the total one-off costs for Republic of Ireland auditors:

Auditor size	Number of audit firms[9]	Hours per firm	Total hours	Cost per hour, £	Total costs, £
Smaller	1,046	4	4,184	35.70	149,369
Larger	13	2	26	35.70	928
Total	**1,059**				**150,297**

7 We estimate the hourly rate for accountants using the 2022 ONS Annual Survey of Hours and Earnings (ASHE), table 14.5a, Chartered and certified accountants, 75th percentile. We convert this figure to 2023 prices using the Bank of England, Inflation calculator. We then apply a 18.8% UK non-wage labour costs uplift to reflect the total costs to entities in scope. The uplift is calculated using data from the latest (ONS) Index of Labour Costs per Hour.

8 FRC (2023) *Key Facts and Trends in the Accountancy Profession 2023,* available at https://www.frc.org.uk/getattachment/6bb377d8-a26d-4084-81b8-829c70e37347/Key-Facts-and-Trends-in-the-Accountancy-Profession-_August-2023.pdf (page 28)

9 IAASA (2023) *Profile of the Profession*, available at https://iaasa.ie/wp-content/uploads/2023/04/Profile_of_the_profession_2022.pdf (page 29)

24 The table below sets out the calculation of the total annual costs expected in respect of the proposed amendments:

Entity size	Entities	Annual hours per entity	Annual hours per auditor	Cost per hour, £	Annual costs, £
Medium	145	5	5	35.70	51,765
Large	269	5	5	35.70	96,033
Total	**414**				**147,798**

25 The equivalent annual net direct cost to business (discounted) (calculated only for the UK) based on the costs stated in the tables above is £290,241.

Benefits

26 The FRC anticipates that the benefits of the proposed amendments will outweigh the costs set out in the preceding section. However, because of the nature of the anticipated benefits, it has been impracticable to quantify them.

27 The intention of the proposed amendments is to provide better quality information to users of affected entities' financial statements, and allow them to better understand the impact of supplier finance arrangements on an entity's financial position and cash flows.

28 Question 4 of the invitation to comment requests comments relating to the consultation stage impact assessment, including any evidence which might help quantify the benefits received, or identify any additional benefit which might arise.

Conclusion

29 Overall, the FRC believes that the proposed amendments to FRS 102 will have a positive impact on financial reporting.

This draft is issued by the FRC for comment. It should be noted that the draft may be modified in the light of comments received before being issued in final form.

For ease of handling, we prefer comments to be sent by e-mail to:

ukfrs@frc.org.uk

Comments may also be sent in hard copy to:

Accounting and Reporting Policy team
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

Comments should be despatched so as to be received no later than 31 December 2023. If you have sent a copy of your response electronically, there is no need to send an additional hard copy.

The FRC's usual policy is to publish on its website all responses to formal consultations issued by the FRC unless the respondent explicitly requests otherwise. An automatic confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. Please be aware that we cannot guarantee confidentiality of consultation responses in all circumstances.

The FRC may not edit (but may redact) personal information (such as telephone numbers or postal or e-mail addresses) from submissions; therefore, only information that you wish to be published should be submitted.

We will process your personal data in accordance with applicable UK data protection laws. Please see our privacy policy.[10]

The FRC aims to publish responses within 10 working days of receipt.

The FRC will publish a summary of the consultation responses, either as part of, or alongside, its final decision.

[10] https://www.frc.org.uk/about-the-frc/procedures-and-policies/privacy-the-frc

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