



Supply Chain Finance (SCF) is more and more main stream within corporate supply chain financing solutions. Implementing an SCF program normally changes the terms and conditions of the trade payables, which could impact balance sheet classification.

## Supply chain finance and its accounting treatment: An empirical study on reclassification of trade payables and its implications for the professional field

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### 1. INTRODUCTION

Supply Chain Finance (SCF) is more and more main stream within corporate supply chain financing solutions. Implementing an SCF program normally changes the terms and conditions of the trade payables, which could impact balance sheet classification. From an accountant's point of view the implementation of an SCF program focuses on the issue of whether trade payables should continue to be classified as an accounts payable or as another liability such as debt finance. The international accounting framework does not provide clear guidance in this matter. Better understanding of the factors that currently play a role in reclassification can improve the transparency on how RFPs should be treated both in practice and in financial reporting.

In this paper the outcomes of an empirical study into Supply Chain Finance and its accounting treatment will be presented. The aim of the study is to indicate the factors that are of importance with regard to the reclassification of trade payables. Also, in this study we want to explore how the current lack in accounting regulations can be tackled, given the fact that uncertainty about accounting treatment of trade payables can play a role in the decision making process of Supply Chain Finance Programs. In short, with this study we will provide an overview of relevant factors in the reclassification of trade payables and shortly discuss the implications of reclassification issues for the professional field.

### 1.1 Impediments in the market

In recent years numerous large buyers have entered into Supply Chain Finance (SCF) programs with various suppliers. These structured programs are facilitated by financial intermediators, using electronic platforms to smoothen the financial processes. This ecosystem helps the respective stakeholders in several ways. Suppliers receive payments earlier at discounted rates, thus improving their working capital (so called DSO; Days Sales Outstanding); buyers can improve their working capital cycle by extending payment terms (DPO; Days Payable Outstanding) and lastly financial service providers (e.g. banks and fintech companies) get access to valuable financial data and receive fees for their services provided. In addition to this, the financial processes within the supply chain will improve by releasing significant amounts of liquidity that has been trapped in its DSO or DPO. In this way, the likelihood of supply chain disruptions by supplier insolvency can be reduced. Over the last few years SCF has proven to be a viable, financing solution with a growing market presence and strong relevance for both corporates, SMEs and financial institutions.

Despite this positive market trend, there are some serious impediments that prevent the implementation of SCF on a larger scale. One issue is the general lack of knowledge and unclarity about SCF and the implementation of SCF within the industry (De Goeij, 2015). Especially when it comes to accounting classification of SCF programs specific regulations are currently lacking which leads to haziness in accounting treatment and economic risks for both suppliers and buyers.

A number of papers have mentioned the shortage of accounting guidance for SCF programs. For example, in 2010 the Association of Corporate Treasurers chaired a working group that was asked to review the supply chain finance market. The Report of the Supply Chain Finance Working Group gives an overview of the main characteristics of SCF and the accounting treatment and risks of buyer driven receivables programs. In 2012 Cass Business School carried out a qualitative research whether accounting implications hinder adoption of supply chain finance and how these organisations are dealing with accounting issues. The study led

to interesting observations and concluded that "IFRS guidance on supply chain finance is required to clarify circumstances that could trigger reclassification of trade payables into borrowings". (Cass Business School, 2012) It was also mentioned that accounting guidance mainly contributes by absence of specific guidelines on this subject. In their Second Edition (2014) of the Supply Chain Finance European Market Guide the Euro Banking Association also pays attention to the accounting aspects of SCF by stating that it is important to achieve the correct balance sheet treatment in order to avoid re-classification of trade indebtedness as bank debt on the balance sheet under certain transactional structures. And lastly the European Securities and Market Authority notes in its October 2015 issue that "(...) some issuers put in place structuring schemes related to their working capital, for example issuers have been increasingly implementing supply chain financing (SCF) arrangements (also called "reverse factoring") for their trade payables. The terms of these arrangements vary, but they generally involve a bank processing the issuer's payments for purchases from suppliers. Considering the potential impact of SCF arrangements on the statement of cash flows and statement of financial position, issuers should analyze the substance of those arrangements. (...) Issuers should ensure that the related transactions which stem from the SCF arrangements are appropriately accounted for in both the statement of financial position and the statement of cash flows." (ESMA, 2015).

When implementing an SCF program, buyers have to be aware that changes to the terms and conditions of the trade payables could impact balance sheet classification. Reclassification of trade payables to bank loans, increases the financial debt held by a buyer. This can negatively impact the buyer's loan covenants and leverage of the firm. The Association of Corporate Treasurers (ACT) mentioned in their 2010 report that "many buyers would see no benefit from a buyer driven receivable program if the trade payables were classified as financing. The objective is for buyers to maintain their payable as trade creditors despite the fact that the supplier may have been paid (early) by a bank or other investor". (ACT, p. 15) Subsequently, buyers will continue to be conservative when it comes to implementing SCF programs, or will even lose their interest. This would be a waste of potential considering the benefits of SCF. Besides, buyers could also end up in financial distress, when using an SCF and clarity on accounting standards is not available. Hence, in practice the absence of clear accounting guidance can result in less adoption and even postponement of SCF programs, drawing attention to this matter of great importance.

To illustrate the negative impact of financial reporting issues in connection with Supply Chain Finance programs we will shortly evaluate the Abengoa case here (see Box 1). The Abengoa case demonstrates that proper accounting of SCF programs is vital for the transparency of financial markets. Also, it shows that SCF programs can contain debt-like features that should be carefully assessed in order to distinguish regular trade payables from bank financing

facilities. Clear accounting rules and policies could provide guidelines to parties that are involved and help understand whether programs can be classified as trade payables or rather should be classified as bank loans.

#### Box 1 The Abengoa Case

*In November 2014 Spanish clean energy company Abengoa's bonds tumbled, as comments made on its results call triggered concerns about how the company accounts for its debt. Banks provide the company with reverse-factoring facilities called "confirming lines", allowing it to pay suppliers within 180 days. Abengoa had €2.2bn of confirming lines outstanding as of June 2014, but does not class this as corporate debt. A note published by Berenberg's fixed-income sales and trading desk described these confirming facilities as "very similar to short term financial debt". It is these facilities that tie-up the € 1.4bn of Abengoa's cash. The company has tried to shift from collateralized bank financing to bond finance for supplier payments in the past, raising short term dollar notes out of a reverse factoring SPV called Greensill Capital last year. But it has since repaid these notes, with the program lying dormant this year. An analyst at a UK asset manager summarized it as follows "If it looks like debt, smells like debt and feels like debt, it should be debt"*

Moody's, one of the three big credit rating agencies globally, has recently assessed the Spanish environment and energy group Abengoa S.A. In its Investors Service of December 15th, 2015 Moody's states that Abengoa's large Reverse Factoring program has debt-like features. Moody's argues this statement by stating that in Abengoa's case (1) "(...) the bank provides funds, which may enable buyers to extend payment terms and sellers to be paid sooner; (2) the bank's payment to the supplier transforms the trade payables into liabilities owed to a bank; and (3) bank credit lines for Reverse Factoring are in most cases uncommitted". (Moody's Investors Service, p. 1) Another important statement Moody's makes in the report mentioned, is that the lack of disclosure of RF programs in the financial reporting can disturb the ability to identify these kind of short term financing in standard credit metrics. Accounting standards do not always require disclosure of this activity and auditors sometimes accept that companies include Reverse Factoring as part of trade payables in their accounts, as Moody's is stating in the report. Finally, Moody's believes that the Abengoa Case is not unique. "As such, we believe that this practice is likely more widespread than is reported, and possibly more so in countries or sectors where reported trade payables are longer-term in nature". (Moody's Investors Service, p.1).

## 1.2 Paper outline

The remainder of this paper is divided as follows. Section 2 briefly describes the concept of Supply Chain Finance (SCF) and Reverse Factoring, the most common form of SCF. This section also deals with the accounting aspects of SCF. First the international accounting regulations will be set out, followed by a description regarding the relevant factors to consider reclassification of trade payables to loans. The findings of the empirical study are described in section 3. This part contains the results of a survey amongst SCF service providers to find out which factors are significant for the professional field when it comes to the classification of Reverse Factoring Programs. In the final section, the main results of the study are presented and discussed.

## 2. Supply Chain Finance and its accounting treatment

In the literature a broad variety of definitions apply to Supply Chain Finance (SCF). One of the commonly used definitions of SCF set forth by the Euro Banking Association (EBA) goes as follows: (...) "the use of financial instruments, practices and technologies to optimize the management of the working capital and liquidity tied up in supply chain processes for collaborating business partners. SCF is largely 'event-driven'. Each intervention (finance, risk mitigation or payment) in the financial supply chain is driven by an event in the physical supply chain. The development of advanced technologies to track and control events in the physical supply chain creates opportunities to automate the initiation of SCF interventions." (EBA, 2014)

### 2.1 Reverse Factoring

Although the definition of SCF can be very broad, the most common form of Supply Chain Finance programs explored and utilized today are Reverse Factoring programs. Illustrative is that in a baseline study in 2016 which was conducted by PricewaterhouseCoopers together with the Supply Chain Finance Community among a wide range of European corporates it turned out that almost 90% of the current SCF programs included Reverse Factoring (PricewaterhouseCoopers, 2016). In this paper we will therefore only focus on the accounting aspects of approved-payables financing from a buyer's perspective, also known as Reverse Factoring, Supplier Finance, or Confirming. Going forward we will use the term Reverse Factoring.

With Reverse Factoring (RF), the buyer sets up the program and enables its suppliers to gain attractive funding based on the buyer's creditworthiness. This means that the supplier is paid earlier at a discount, while the buyer extends the payment date of the invoice. The bank or other financial intermediate party funds the program and receives a fee without much

risk, since the creditworthy buyer covers the payment of the invoices. In practice, these RF programs are buyer-initiated and implemented with the help of web-based platforms, which can be provided by either the financier or by an independent platform provider. In figure below (figure 1) we graphically show how the mechanism works.

The supplier sends an invoice to the buyer together with the physical delivery of the goods. After receiving the goods the buyer can approve the invoice and upload it manually or automatically to the platform. This approval is a payment guarantee from the buyer that allows the supplier to receive funds directly from the financier. When the supplier wants to access these receivables, the financier advances a payment with a discount based on the buyer's borrowing rate. This credit allocation uses the buyer's payment guarantee as collateral, leading to a favorable borrowing rate. At the end of the credit period the buyer pays the financier, irrespective of the financial situation of the supplier.

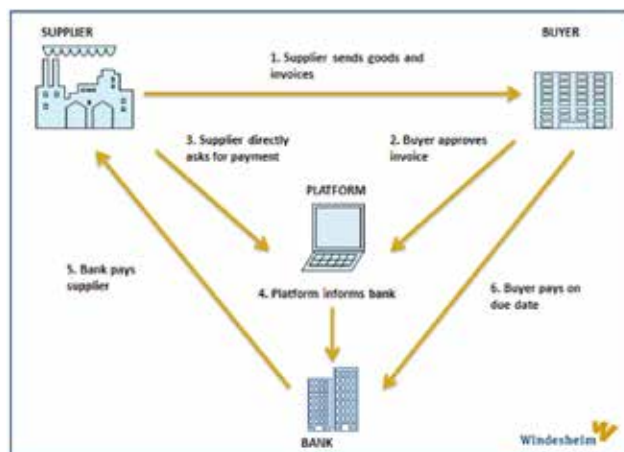


Figure 1 Process of Reverse Factoring

## 2.2 International accounting regulations

From this section onwards the accounting implications of Reverse Factoring will be discussed. First, a description of the existing guidance in financial reporting will be outlined to put the accounting treatment in the right perspective. This will be followed by an overview on common factors that are applied in the accounting classification of Reverse Factoring.

In the existing guidance one of the challenges is the diverse character of Reverse Factoring (RF) and the different accounting standards that are applicable worldwide. There are

two leading standards: IFRS (International Financial Reporting Standards) and U.S. GAAP (Generally Accepted Accounting Principles). The major difference between the two leading standards lies in the conceptual approach: U.S. GAAP is rule-based, whereas IFRS is principle-based. This difference in approach also explains why the methodology to assess an accounting treatment differs. Under U.S. GAAP, the research is more focused on the literature, whereas under IFRS the review is focused on the fact pattern. As we will see, the financial reporting question is whether trade payables should continue to be classified as such in the buyer's books or if the Reverse Factoring Program would cause the trade creditor to be extinguished and be replaced by a different liability of an unspecified nature (other liabilities) or even of a financing nature (bank loan). This implies that the facts that have led to implementing the RF program is of great importance.

### IFRS

According to IAS 32.1 a financial instrument is "a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity". (Deloitte, 2016) Hence, IFRS classifies trade transactions between a buyer (debtor) and a vendor (creditor) as a financial instrument, causing a trade payable respectively trade receivable in the accounting of both the buyer and the vendor. Normally, on due date the buyer pays its debt to the vendor and the trade payable will be extinguished. Also in the books of the vendor the accounts receivable will be settled as soon as the payment has been done.

As to Supply Chain Finance Programs there is very little guidance in IFRS. The accounting standard that is most relevant in this respect is International Accounting Standard 39 Financial Instruments: Recognition and Measurement. According to IAS 39.39, an entity shall remove a financial liability from its balance sheet when, and only when, it is extinguished; that is when the obligation specified in the contract is discharged, cancelled or expired. This condition is met when the financial liability is settled either by paying the creditor (supplier) or when the debtor (buyer) is legally released from primary responsibility for the liability (either by law or by the creditor) according to IAS 39.AG57.

### U.S. GAAP

There is no specific U.S. GAAP in this respect. The U.S. Securities and Exchange Commission (SEC) staff discussed the classification of certain trade accounts payable transactions involving a financial intermediary in two separate speeches in 2003 and 2004. The SEC staff noted that all facts and circumstances specific to each individual transaction must be thoroughly analyzed, but specifically referred to situations where the buyer benefits by either a) a repayment date from the financier that extends beyond the due date of the original trade payable, or b) a portion of the trade discount taken by the financier via a slight reduction in the amount due to the financier on the payables' original due date. The SEC staff believes

that in the case of these situations the economic substance equates to the buyer obtaining financing from a financier in order to pay amounts due to its supplier. Re-classification of the trade payable to debt would be appropriate upon its transfer to the financier.

### 2.3 Factors to consider for reclassification

According to PricewaterhouseCoopers - as stated in a regular report of PwC released in 2013, in which financial reporting issues are reviewed (called: Data line) - the analysis of the SEC staff as described above should focus on whether changes of a company's trade payables require reclassification to debt. In other words: *are the terms substantively different from those typical of a "normal" trade payable?* PwC argues that it should be determined to which extent the initial obligation is in fact a trade payable (i.e. a trade payable as a result from the purchase of a good or service by the company from its vendor on terms typical of similar purchases in the applicable jurisdiction and market). In PwC's observation of the many factors that should be considered the basic questions are 1) have the terms of the trade payables changed as a result of the Reverse Factoring program and 2) are any new terms consistent with the terms of normal trade payables? In cases where any of the changes made to the terms of the RF program indicate that the characteristics of the liability have changed, this can imply that the liability is no longer a trade payable and has become more of a "debt-like" obligation. (PricewaterhouseCoopers LLP , 2013)

Factors that are mentioned in said PwC report and include these kind of features are summarized in the table below, items 1 up to 3 (table 1). Another factor in considering the economic substance of the trade payable, is whether the legal characteristics of the liability have been changed, according to PwC. "If the legal characteristic is no longer that of a trade payable, the liability should be accounted for as a financing". (PricewaterhouseCoopers LLP , 2013). For factors that should be considered as legal terms and conditions within a RF program please refer to the table below, item 4.

In 2010 the Supply Chain Finance Working Group published a report in which the group did a review of the supply chain finance market at that time. It is stated that accounting treatment needs careful consideration in order to assure that the RF-facility can be consolidated as a trade payable. Furthermore, the report provides certain key elements of a RF-structured program that should be considered as a risk in altering the economic substance of the trade payable. For factors mentioned by the Supply Chain Working Group, please refer to table 1.

Although the factors mentioned in both reports are somewhat different, they appoint the same underlying features. As table 1 clearly illustrates the factors mentioned in both reports can be categorized in the following four (4) criteria: payment terms used by the buyer with its vendors; buyer's role in the RF Program; whether credits (e.g. discounts, rebates and returns),

fees and other payment features are (not) in line with trade payable arrangements, and; legal characteristics of the liability.

It should be noted that in practice accountants will not only use the factors above for the qualification of the economic substance of the trade payables, but may also embed them in the assessment of the Reverse Factoring Program by means of listing a set of qualitative criteria. Given the research constraints, we will not go into further detail about using these factors as assessment tool, but rather employ the criteria as mentioned in table 1 to present and analyze the results of the survey, which was conducted as part of this study.

**Table 1** Factors to be considered according to the literature

Criteria	Factors	Source
1 Extended payment terms used by the buyer with its vendors	<ul style="list-style-type: none"> <li>- buyer needs consideration of trade payables with extended due dates and terms that are customary for its trade payable arrangements across a broad range of its suppliers</li> <li>- allowance of the buyer to extend payment terms on outstanding invoices or future ones</li> </ul>	(Association of Corporate Treasurers, 2010) (Association of Corporate Treasurers, 2010)
2 Buyer's role in the RF-program	<ul style="list-style-type: none"> <li>- buyer's participation in the structured program should be voluntary and buyer should have allowance to retain its right of negotiations with the vendor and ability to withhold payments</li> <li>- the buyer has any ongoing level of control over the investor/funding vehicle</li> </ul>	(Pricewaterhouse Coopers LLP , 2013) (Association of Corporate Treasurers, 2010)
3 Credits, fees and other payment features are (not) in line with trade payable arrangements	<ul style="list-style-type: none"> <li>- credit notes or early pay discounts received by the vendor that are (not) customary to normal trade payable conditions or discounts / fees received from the bank related to trade payables but actually reflect finance abilities secured by the company</li> <li>- rebates to be shared between the buyer and the supplier</li> </ul>	(Pricewaterhouse Coopers LLP , 2013) (Association of Corporate Treasurers, 2010)
4 Legal characteristics of the liability	<ul style="list-style-type: none"> <li>- interest payments due to payables outstanding resp. funding to the buyer;</li> <li>- draw-down of existing or new credit lines the company may have with the bank;</li> <li>- altering the seniority of the trade payable in the company's capital structure;</li> <li>- requiring the company to post collateral to secure the collectability of the trade payable;</li> <li>- Incorporating cross-default provisions that accelerate repayment of trade payable of the company.</li> <li>- obligation from investor to buyer that funding (to pay other than on normal trade terms) will be available to suppliers;</li> <li>- the buyer to be a party to the arrangements between the investor and the supplier;</li> <li>- the buyer's obligation to a supplier is replaced with an obligation to an investor</li> </ul>	(Pricewaterhouse Coopers LLP , 2013) (Association of Corporate Treasurers, 2010)

### 3. Research findings

The remainder of this paper summarizes the outcomes of a survey amongst SCF service providers. The responses substantiate the views expressed in this paper and are reproduced in graphs relating to the discussed factors. A limitation of the research is the limited number of interviewees that participated in the survey (n = 13). Notwithstanding, the respondents were all experts and therefore their opinions should be highly valued. To validate the outcomes of the survey depth interviews have been held with financial and accounting experts in the field. Therefore, we are of the opinion that this research will gain further insight in this subject and can contribute to solve current issues in the market.

#### 3.1 Methodology

First, a literature review was made to assess the existing knowledge about accounting aspects in Reverse Factoring Programs (RFPs). Academic and practitioner sources were used for this purpose. With this knowledge semi-structured interviews were conducted with corporates and accounting professionals in the field to confirm or enhance the knowledge in this area. Based on these interviews a survey was constructed which aimed to make explicit the most compelling factors that indicate whether or not RFPs may lead to reclassification of trade payables into financing. This quantitative information grasps a lot of the implicit knowledge present with the financial service providers and provides an insight in how they view and assess the related factors. Furthermore, several interviews were held with accounting experts to verify the survey outcomes and gain deeper knowledge of the subject. In-depth interviews were held with the Big-4 accounting firms in the Netherlands.

#### 3.2 Survey findings

By conducting a survey we want to determine which factors are significant in the reclassification of trade payables to loans. We would like to focus on financial service providers and see which factors might indicate financing, i.e. these might indicate that the RFP causes the trade creditor to be extinguished and be replaced by a different liability of a financing nature. This particular group was targeted, because these stakeholders are dealing with the different players (buyers, suppliers, IT) and have an overview in the market. Therefore, they can look from different angles and take different perspectives into consideration, when being asked about the critical factors that are determinative for the assessment of RFPs and re-classifications matters.

In the box below (Box 2) you will find the survey questions for each of the four categories as mentioned in table 1 (see section 2.3). These (sub-)questions relate to the factors indicating financing that form a potential risk for reclassification.

Item	Questions
<i>Below you will find a list of factors indicating financing (i.e. form a potential risk for reclassification). Can you please indicate how relevant each factor is in your opinion? (5 points Likert scale)</i>	
a	Payment term extension does not stay with the ordinary course of business.
b	The buyer gives guarantees to the bank or the supplier to facilitate the supply chain financing program.
c	Credit notes cannot be offset against the related payables, but against future supplier invoices.
d	Involvement of the buyer in the negotiations between the supplier and the bank.
e	The buyer receives fees or other payments from the bank or makes any payments to the bank other than payment of the original invoice under its terms
f	The buyer pays interest to the bank prior to the date the trade payable is due to be paid.
g	Extended payment terms and finance is only offered to those suppliers who are part of the supply chain finance program.
h	The web-based payment platform is only available to suppliers whose payment terms have been extended.
i	There is a tri-partite agreement between the buyer, supplier and financier.

#### Box 2 Survey-questions with regards to factors indicating financing

The outcomes of this survey are presented, using the classification of table 1:

- Extended payment terms used by the buyer with its vendors (3.2.1);
- Buyer's role in the Reverse Factoring Program (3.2.2);
- Handling of credits, fees and other payment features (3.2.3);
- Legal characteristics of the liability (3.2.4).

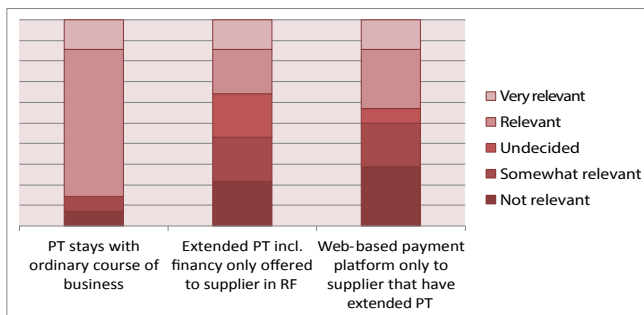
##### 3.2.1 Extended payment terms

To illustrate that the obligation specified in the contract still holds the characteristics of a trade payable, a buyer will need to make sure that the adjusted terms of the obligation are common for its RFP's across a broad range of its suppliers. It may be a challenge to argue that these terms represent common trade payable terms, if the adjusted terms are only present with a small number of the buyer's suppliers or are only offered to a small selection of the supplier base.

This does not mean, however, that the payment terms of every supplier need to be extended

to illustrate that the terms of the obligation represent a common trade payable. Sometimes buyers may extend their payment terms and initially roll out the RFP with only its largest or its strategic suppliers. Although it is not necessary for the buyer to offer the program to every supplier, the supplier base needs to be broad enough to illustrate that the obligation still holds the characteristics of a trade payable. Also it helps when a Corporate Payment Strategy underlines the RFP initiative.

Besides that, buyers should also analyze the range of payment terms by jurisdiction. As part of that analysis, the percentage of trade payables with extended payment terms that are factored to banks as part of the RFP should be taken into account. In a case where the factored trade payables are limited to the trade payables with extended payment terms, and where all trade payables with extended payment terms are factored, this may indicate that the terms are not commonly compared to “regular” trade payables in those jurisdictions. This may mean that the characteristics of the original trade payable have changed and reclassification of the trade payables with extended terms to financing/debt may be appropriate.



**Table 2** Payment term extension

Table 2 shows that with regard to payment term extension the most essential factor is that the payment term stays within the ordinary course of business. In other words, if the payment terms in an RF program deviates from the normal payment term that might be an indication that the substance of the liability has changed from a trade payable to debt-like financing.

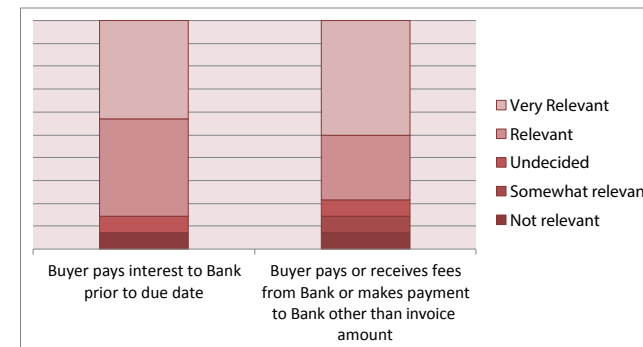
### 3.2.2 Buyer's participation in Reverse Factoring Program

In a Reverse Factoring Program, a supplier's decision to factor its receivable from a buyer to a bank does normally not affect the buyers cost of goods or services received from that supplier. However, the buyer may have secured financing from the bank at a favourable

rate, if the buyer receives a discount or a fee from the bank that relates to its trade payables factored by the buyer's supplier.

Besides that, if a buyer is involved in any early payment discount that the bank negotiates with the supplier, in spite of settling the payable on its due date, this may indicate the terms of the trade payable have been changed. As a common trade payable characteristic, this would not represent the ability to participate in payment discounts beyond the period stated on the invoice and which may therefore indicate that reclassification to financing/debt would be appropriate.

Furthermore, a trade payable does not contractually provide for interest during the period it is outstanding. While it is common for penalties to be imposed by suppliers if the trade payable balance is not settled on the due date indicated on the invoice, it is not common for the buyer to pay interest prior to that point. If, however, the buyer does pay interest prior to the due date though this may suggest the obligation is more likely to be financing.



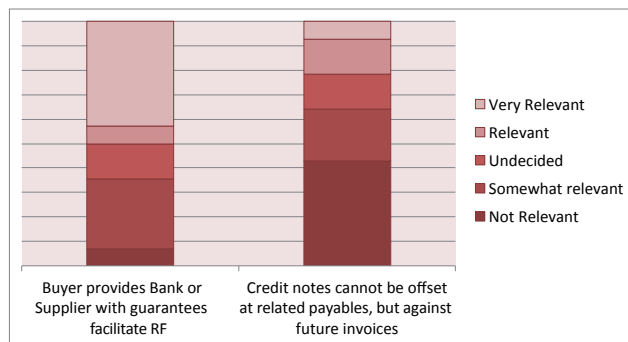
**Table 3** Participation of buyer in Reverse Factoring Program (RFP)

Table 3 shows that according to the respondents both indicators are significant factors. Hence, interest and other fees paid to the bank are an important factor in determining whether the RFP includes debt-like features.

### 3.2.3 Handling of credits, fees and other payment features

In the case of quality failures or damaged goods, the supplier issues credit notes to the buyer. Credits are normally negotiated between the buyer and the supplier. The buyer also has the ability to withhold payment if there are disputes. If the buyer is not allowed to retain its rights of negotiation with the supplier and if it is not able to withhold payment because of a RF program, the economic substance of the trade payable may have changed. If a buyer for

example receives damaged goods from its supplier and the buyer must pay the bank the full amount and negotiates a credit on a future invoice, this may indicate the buyer no longer holds its right to offset for that particular payable. Adjustment on a future invoice is however not an issue in the case of common practice.



**Table 4** Rights and guarantees

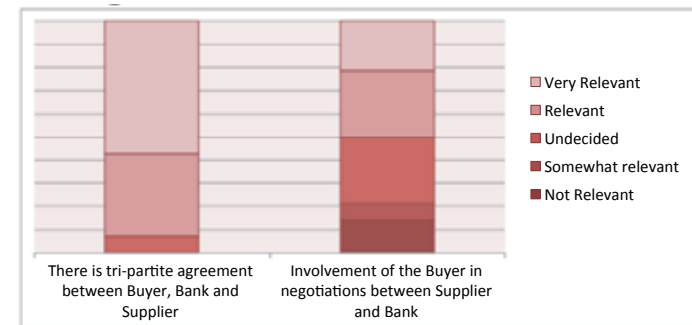
Table 4 shows that guarantees to bank or supplier to facilitate RF programs and provided by the buyer are an important factor in determining the economic substance of the trade payable. The possibility of off-setting credit notes to future invoices is of minor importance, according to the findings of the survey.

### 3.2.4 Legal characteristics of the liability

The roles in the negotiation process of all parties involved, should be analyzed as they may indicate whether or not the economic substance of - or legal rights associated with - the original trade payable have changed. If the buyer has been involved in the negotiations between the supplier and the bank, this may suggest that the buyer has been influential in these negotiations and that the terms of the original payable have been changed from the buyer's perspective. In general, this is why buyers cannot be involved in pricing discussions, which complicates / lengthens the onboarding of suppliers.

If there is a tri-party agreement where the buyer, supplier and the bank are all signatories, this may indicate that the buyer has been influential in negotiations between the supplier and the bank. The higher the level of influence of the buyer in the negotiation process between the supplier and the bank increases, the more challenging it becomes to acknowledge that the buyer does not have a financing at the bank to pay its supplier. As such, balance sheet reclassification of the trade payables to debt may be appropriate there where the facts and circumstances indicate that the buyer is borrowing from a bank to pay its supplier.

Moreover, it is important to assess whether the legal characteristic of the original liability has changed. If the legal characteristic is no longer that of a trade payable, the liability should be reclassified as financing.



**Table 5** Legal Structure and Involvement

Table 5 shows that the existence of a tri-party agreement is an important factor that may point to financing. That is why it is important to have the right legal structure in place and the reason why there are - in general - separate agreements between each of the parties (buyer, supplier and bank) involved.

### 3.3 Accounting experts point of view

In order to validate the outcomes of the survey several interviews were held with accounting and financial experts of the leading accountancy firms in the industry. Depth interviews were held with a total of three (3) interviewees from the four largest accounting firms of the Netherlands. The interviews were conducted using semi-constructed questionnaires, based on the literature review and the survey. Also, a consultancy expert partook in the interviews and to add his expertise.

During the interviews the following topics were discussed:

- Factors to consider for RF-classification;
- Survey findings as presented in the draft-paper;
- Conclusions with respect to the survey.

In general, there was a large consensus amongst the interviewees with respect to the different topics. Therefore, the findings below will be presented in an integrated way.



With regards to the question: *Do the factors as presented in the survey give a complete view of all factors that are involved in a Reverse Factor Program?* it was the interviewees' opinion that the listed factors give a complete and accurate view of the practical setting in which Reverse Factor Programs are being assessed.

Another topic that was touched on during the interview sessions was the presentation of the survey findings. Here the comments were limited and general conclusions cannot be drawn. However, none of the interviewees found that the survey findings were in contrast with their perceptions or views.

Regarding the paper's main conclusion - based on both the survey and literature study - that changing the terms of the trade payables is the most viable factor in reclassification, the comments varied. One of the participants responded that in practice the payment terms may vary, but the underlying contracts are being drafted in such a way that they comply with the terms and conditions of normal trade payables. Another participant responded that payment extension is not the issue, but rather the treatment of the category of suppliers which join the program in relation to the treatment of the suppliers which choose to not participate.

None of the participants agreed with the statement that clear accounting rules and policies might provide guidelines to the parties involved and would facilitate the process of implementing RFPs on a regular basis. Interviewees all held the opinion that indeed the current regulations are not adequate and cannot provide enough guidance for accountants or the professional field. However, more and stricter regulations would not be the solution to tackle this problem. The market will evolve quickly and regulations cannot keep up with these developments, they argued. In other words, too many programs that either are either in place or in the stage of implementation are not ruled by (more) regulations.

Moreover, all participants agreed with the statement that the best way to solve this issue is to disclose the programs in the financial statements. The second best option would be a principle based approach in the sense that the accounting treatment should be based on the underlying business question: *What is the real intention to start with a Reverse Factoring program? Is this to facilitate the suppliers by pre-financing them or is the set-up of the arrangement driven by the fact that the buyer itself seeks for financing of its working capital by lengthening its DPO?* Also, seen from a finance perspective, re-classification will not have an impact on the cash flows of the company. Hence, there is no real difference between financing the DPO with accounts payables or debt-financing. In this sense this issue is strictly bound of accounting and should be solved either by principle based regulations or by full-disclosure of the accounts payable programs, as viewed by the participants in the interviews.

#### 4. Discussion and conclusion

In this section we will lastly discuss the findings of the study and will conclude with some reflections upon the way to go forward in order to provide more clarity for the market when it comes to reclassification issues of trade payables.

Based on this study it can be concluded that there is a wide consensus in the market about which factors determine possible re-classification of trade payables in the balance sheet of the buyer when implementing Reverse Factoring Programs. Not only the literature, but also empirical evidence shows a number of factors that play an important role in the reclassification issues.

The most important factors that resulted from the survey are the following:

- Payment terms need to stay within the ordinary course of business;
- Elements such as interest, fees and guarantees paid by the buyer to the bank and/or supplier should be carefully assessed since they include financial, debt-like features;
- Issuing of separated agreements and exclusion of tri-party agreements to emphasize the bi-lateral relations between parties.

For the market these factors provide an insight in the necessary conditions for adjusting terms of trade payables and the underlying contracts with respect to RFPs.

Also, these factors can be seen as criteria for assessing the terms and conditions in an RFP. In that sense, the set-up of RFPs is being seen from a principle based view in which the intention of the original arrangement defines the economic substance of the financial instrument. This treatment is closely linked with the principle based accounting concept of the IFRS regulations. In its 2015 Exposure Draft of the conceptual framework the IFRS reintroduced this so called "substance over form" principle. The IFRS clarifies this principle as a faithful representation of financial reporting which provides information of the substance of an economic phenomenon instead of merely providing information about its legal form.

Moreover, the draft text of the re-introduction of the "substance over form" principle states that "(...) there will be transactions for which the substance and the legal form differ. In practice, common features of such transactions often include: the deliberate separation of legal title and the underlying benefits (e.g. leases, consignment inventories, factored debts and the use of structured or special purpose entities) (...)" (IFRS, 2015).

In this text IASB refers to factored debts as an example of transactions for which the substance and the legal form differ. Hence, in the case of factored debts (e.g. RFPs) it is not the legal form, but the substance that is the leading principle which defines the nature of the debt.

However, as one of the respondents subtly remarked: “First price would be full disclosure of the classification of trade payables (including RFP), second price would be principle-based accounting and the last resort is a rule-based accounting treatment”. In other words, the best option for the market and financial parties in particular (e.g. banks, investors, credit-rating agencies etc.) in particular would be full disclosure of these kinds of arrangements. Despite the unlikelihood in the first instance, there seems to be a tendency in the market that more and more companies disclose trade payables arrangements as a separate line-item in their financial reports. That would be the best way to give clarity about the economic risk profile of any particular company, so that investors can have a truly clear picture of the true nature of these liabilities. Whether the market is ready for this kind of transparency is still doubtful, though it seems worthwhile to make a collective call to the international setting boards to provide clarity in this matter.

#### 4.1 Final conclusions and further steps

When implementing a Reverse Factoring scheme buyers have to be aware that changes to the terms and conditions of the trade payable may impact balance sheet classification. The financial reporting question is whether trade payables should continue to be classified as such in the buyer's books or if a supply chain finance program would cause the trade creditor to be extinguished and be replaced by a different liability of a financing nature (a bank loan).

However, there is no clear guidance from IFRS which buyers can use when assessing trade payables with reverse factoring arrangements. Besides, auditors will assess the Reverse Factoring Programs case-by-case to figure out whether the trade payables in the scheme would need to be reclassified as a bank loan. As pointed out there are various factors to do so. From the literature a synthesis was made that included four (4) factors that play a role in the reclassification of trade payables. From the survey we learned that there is large consensus on most of these factors and should therefore be considered when assessing RFPs.

Besides that, it seems that the momentum has come to request for more clear guidance of the current accounting standards. This is recommended from both the corporate as the advisory practice. Either full disclosure or a principle based approach is herewith deemed necessary. The key-question in this matter should be: *what is the underlying intention and what is the business case when implementing RFPs?*

Finally, further research is recommended to get more in-depth knowledge of the specific accounting procedures that are applicable for the accounting treatment of trade payables with an RF-basis. Important sources that still needs to be investigated are hand books, procedures and guide lines that accounting firms use when auditing companies. This will lead to a better and fairer treatment of RFPs and will limit the differences between auditing firms in assessing these programs. Also, this research can provide more alignment for RFPs, which will be of great interest for the SCF community.

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