

Encountering accounting issues in Reverse Factoring?

What is Reverse Factoring or Supplier Financing?

Reverse Factoring (RF), also called Supply Chain Finance or Supplier Financing, is a confirmed payables-based financing solution established by a company (Buyer) and a Funder whereby the Funder commits to pay Buyer's invoices to certain Suppliers at an accelerated rate in exchange for a discount. Typically, the Buyer requests Suppliers to extend their commercial terms as a condition for the Supplier to join the RF program.

The objective of establishing an RF program is for the Buyer to help its Suppliers finance their extended receivables more easily and at a lower interest rate than what they would obtain on their own, assuming that the Buyer has a better credit rating than the Suppliers, whilst benefiting from longer payment terms.

The legal framework of RF is generally based on a Supplier Finance Agreement established between the Buyer and the Funder, and Receivables Purchase Agreements executed by the Funder with each Supplier being on-boarded into the RF program.

Accounting uncertainties in Reverse Factoring

RF programs have been in use for quite some time now, however there is no specific reference to them in the accounting standards. This has created uncertainty for companies in terms of the accounting treatment that applies. Once an RF program is in place, the key question is whether the Buyer can continue to book trade payables towards the Suppliers, or it has to consider them as liabilities of a financing nature (debt or bank loan), particularly for the days in excess of the standard terms the Buyer has with other Suppliers or had with the relevant Suppliers before introducing them to the RF offering.

To address this issue, general guidance can be taken from IFRS 9 (IAS 39). In principle, if the substance of the contractual terms of the agreement does not differ and therefore the amounts owed to the Funder are akin to amounts owed to the Suppliers, the Buyer may consider such obligations as part of its normal operating cycle and disclose them as trade payables¹. However all facts and circumstances should be considered carefully, as differences in contractual terms can be decisive.

¹ Deloitte Australia. March 2017

There are numerous factors in RF programs that may determine the need for the Buyer to reclassify the related trade payables as financial debt, such as the sample ones below²:

Extended credit terms	When payment terms for the Suppliers in a RF program are substantially longer than the normal payment terms across the business and/or the extension of payment terms is not available to the Buyer under normal trading conditions.
Additional credit enhancements	When credit enhancements are added, such as collateral from the Buyer (or its parent).
Credits, fees and other payment features	When RF features are not in line with trade payable arrangements. For instance, the Buyer receives some kind of compensation from the Funder related to the volume factored, or the Buyer is still required to pay the Funder in full despite receiving damaged goods, and must negotiate a credit note with the Supplier.
Funder commitment	When there is a Funder obligation towards the Buyer that funding will be available to Suppliers.
Legal novation	When the Buyer's obligation to a Supplier is replaced by an obligation to a Funder.
Tri-party agreement	When Buyer, Supplier and Funder are all signatories to the RF agreement, it may indicate that the Buyer has been influential in negotiations between the Supplier and Funder and therefore, prompt debt reclassification.
Restricted number of Suppliers	When the number of Suppliers included in the RF program is very restricted.

Avoiding accounting issues with receivables-based solutions

The ultimate aim of Buyers establishing an RF program is to enhance working capital, which they achieve via the accounts payable (AP) side. However, Buyers with RF programs are usually large companies with a considerable accounts receivable (AR) position in their balance sheet, which could be used to accomplish the desired working capital objectives without running the risk of debt reclassification, as AR-based solutions have a more clearly defined accounting treatment.

There are various types of AR-based financing programs, many times based on the "true sale" of receivables leading to off balance sheet treatment of AR and working capital improvements. Moreover, AR-based programs can incorporate a sales acceleration stimulus – in which case they are called Distribution Financing (DF). In essence, DF is an AR-based financing program established by a company with a Funder involving a selected portfolio of Buyers. The company extends the payment terms offered to these Buyers and at the same time, accelerates

² Supply Chain Finance and its accounting treatment. 2017. Supply Chain Finance Community.

collections by selling the AR to the Funder on a true sale basis. The benefits obtained with DF are:

- The company enhances working capital by decreasing Days of Sales Outstanding (DSOs) given the AR true sale recognition, whilst at the same time boosts its competitiveness by improving the offering to Buyers
- Buyers improve cash flow and working capital metrics (increase DPOs) as the extension of terms is considered by them as trade payables.

Balance-sheet wise, DF is an efficient way of financing working capital, as it does not impact debt and it greatly improves the cash flow and liquidity of all participants. Companies with RF programs should consider DF as another way to enhance working further, or even as a beneficial replacement of RF.

Alternative Distribution Financing Ltd. ([ADF](#)), part of the GSCF Group headed by the leading servicer Global Supply Chain Finance Ltd. ([GSCF](#)), specializes in setting up and financing DF programs involving large companies with complex portfolios of Buyers spread globally.