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Briefing: The impact of new supply chain finance accounting regulations

What you need to know about the coming changes and alternative models for funding essential supply chain initiatives

It is no longer a question of "if"

The time to analyse the potential impact on your business and pro-actively make changes is now

Executive summary

Regulators are implementing far-reaching disclosure requirements for supply chain finance (SCF) programs. The changes, being pushed globally by the International Accounting Standards Board (IASB), Financial Accounting Standards Board (FASB), UK-based ratings agency Fitch, and others, will require companies to publicly disclose the size and scope of SCF programs.

The worst-case scenario: SCF will be re-classified as debt, creating a wave of consequences across the economy, including potential downgrades, increased funding costs and more supply chain risk.

It is no longer a question of "if." The time to analyse the potential impact on your business and pro-actively make changes is now.

This report covers the questions you need to ask – and answer – to make an informed and effective pivot:

- **What is driving the renewed call for disclosure of SCF programs?**
- **What are your options in the new regulatory environment?**
- **Are there alternative solutions available to you today to maintain working capital and supply chain resilience?**

CFOs & Treasury Leaders:

What you need to know

New regulations will force you to change how you fund SCF programs.

Your promise-to-pay obligations risk being reclassified as debt.

Consequences include loss of working capital, increased borrowing costs, supply chain disruption and higher compliance costs.

There are alternative models to maintain the essential benefits of SCF while eliminating the "Promise to Pay."

Are there alternative solutions available to you today to maintain working capital and supply chain resilience?

New disclosure requirements: Why now?

SCF programs have been instrumental to buyers and suppliers for decades. Why change the rules now?

There's a perfect storm driving the shift:

- Global trade and capacity remain strained.
- High-profile financial failures, labour shortages and severe supply chain disruptions continue to interrupt growth.
- The sheer size of global SCF trade – which McKinsey estimates to be over $7 trillion[1]– creates risk.

Combined, these threats make detailed disclosure an imperative. Regulators do not want to risk more disruption at the hands of overzealous borrowers and misrepresented financial stability.

In late June 2021, the International Accounting Standards Board (IASB), which sets accounting standards broadly followed by more than 140 countries, decided to create new standards for SCF. The decision was made due to the concerns of investors and regulators who say they are unable to gain a clear picture of a company's finances when such arrangements are not reported.

If only it were simple. SCF programs are highly complex and include a wide variety of reporting models. There's also significant uncertainty about the size and scope of global programs with just 5.4 percent of large cap companies disclosing SCF programs.[2]

> "Calls for the reverse factoring accounting treatment reform have become even more urgent as the pandemic has spurred demand for SCF because companies were scrambling to improve their liquidity."
>
> Fitch Wire, Mar. 22, 2021

This makes crafting equitable (and enforceable) disclosure requirements challenging, as articulated by Deloitte:

"In practice, the impact of a supplier finance arrangement on the presentation of a financial liability is likely to involve a high degree of judgement based on the specific facts and circumstances."[3]

Clearly, these issues are not easy to resolve. But that means little for finance and treasury leaders. Regardless of the uncertainty, change is here and the implications are far-reaching.

1 McKinsey Global Payments Report May 2021, pgs. 19-24

2 Global Trade Review, June 30, 2021 by J. Atkins (https://www.gtreview.com/news/global/supply-chain-finance-set-for-new-disclosure-rules)

3 Deloitte A&A Accounting Technical brief, July 2018, pg. 5

The impact of disclosure: Caught between a rock and a hard place

Today, SCF programs are built on a "Promise to Pay", and generally appear on the buyer's balance sheet as a "Trade Payable". Under current rules, this category of financing is not recognised as debt financing nor disclosed in financial statements.

Unfortunately, the new disclosure requirements will force companies using SCF programs to make tough choices: reduce programs, eliminate the "promise to pay", accelerate payments, or take on debt.

These options have hard consequences – with implications on innovation, growth, financial performance and more. Consider the outcomes:

If you accelerate payments or reduce SCF programs: The loss of working capital will affect day-to-day operations, R&D investment, customer acquisition, market expansion, valuation and more.

If your SCF program gets reclassified as debt: Your ability to raise money, secure favourable interest rates, meet contractual obligations and maintain high credit ratings will be hampered.

In every scenario, your supply chain stability and resilience take a hit: Suppliers and supply continuity will be constrained. CSR programs will be underfunded and resource-strapped procurement and supply chain teams will be stressed to the breaking point.

Your operational and compliance costs will also rise: Tracking, management and reporting will require significant new investment in administrative overhead.

There is a proven alternative. New early payment models are enabling businesses to maintain the financial benefits they experience today and transform how they fund the supply chain.

> "The presentation of the financial liability matters, as it may have significant impacts on the purchaser's financial position..."
>
> Deloitte A&A Accounting Technical brief, July 2018[3]

Balancing transparency & cash-flow optimisation

At the core, demands for increased disclosure about SCF programs call for more clarity and transparency. This is a good thing. Finance, treasury and supply chain executives recognise that transparency is key to every relationship. At the same time, they need ways to responsibly improve cash flow. The two are not mutually exclusive. The good news is that innovation makes it easier than ever to achieve both objectives while increasing resiliency and social responsibility.

There is a better way to finance supply chain programs: Eliminate promise to pay

It may in fact be time to reconsider SCF programs on the whole. Current models leave all but the strongest suppliers with poor terms and negatively impact third-party resilience. Few businesses can endure more uncertainty following 18+ months of pandemic-induced supply chain and financial disruption.

Given the state of global supply chains, what supply chain partners really need is clear:

1. Buyers need an efficient, quick and simple way to pay suppliers and invest that doesn't require financial obligations to financial institutions.

2. Suppliers need a simple way to get paid sooner, without giving up critical margin. Both buyers and suppliers need to maintain operations and avoid the possible disruption that SCF disclosure may cause.

This raises a critical question:

> Is there a better way to maintain the powerful and essential benefits of SCF while eliminating the "Promise to Pay" bugaboo?

The answer is unequivocally "yes".

The solution is to move beyond traditional SCF programs and embrace modern and enabling machine-learning technologies that eliminate the need for the "Promise to Pay."

Previse's AI-driven early payment solution adopts an industrialised factoring platform that delivers what SCF programs promised: **buyers support suppliers with access to cost-effective early payments without creating new financial obligations**. The approach reduces costs, compliance headaches and the impact of impending disclosure requirements that come with traditional SCF.

Today's AI-driven industrialised factoring programs:

- Do not require financial obligations from the buyer
- Assume both supplier and buyer risk
- Industrialise the redirection of maturity payments at scale
- Streamline accounts payable and accounts receivable operations
- Provide 100% advance rate at fractions of the cost of factoring solutions.

The result is easy, seamless payments that lower risk for all parties, optimise margins and strengthen supply chains.

The best part: There’s no impact to trade payable treatment as there is no “promise to pay”

Buyer benefits

- Existing obligations to trading partners remain the same but “Promise to Pay” is not required.
- Strengthen trade payable treatment and remove the risk of disclosure or debt classification
- Zero impact on working capital or debt ratios
- Extend support to suppliers by offering immediate payments
- Socially responsible funding
- Compliant with prompt payment regulation
- Payment flexibility
- Lower costs
- Easy to implement with existing P2P, payment platforms, or directly with an ERP system

Supplier benefits

- Simple and easy access to advanced payments
- Reduced risk
- Operational efficiency

Start your journey to the future of supply chain funding today

Forward-looking finance leaders are not waiting for regulatory agencies to hammer out the final SCF disclosure standards. They are acting now to put their organisations and supply partners in a better position, financially and operationally.

The window remains open for you to expand the options you have for financing supply chain programs. With an innovative model that relies on AI (not lending), your organisation can keep supply chain relationships strong, fund innovation and build value for stakeholders and shareholders alike.

Previse's solution is an effective and proven model for early payments that offers game-changing benefits for buyers and suppliers.

Suppliers send invoices

Invoices are sent by suppliers just as they are today.

Immediate payments

When you receive the invoice, payment is made by Previse (less a small fee), pre-approval.

You process as normal

Buyers continue their settlement process and pay Previse when ready, less any adjustments, at Previse's risk.

Contact us. Email info@previ.se to learn more and strengthen your organisation's position for effective response to change – whenever it arrives.

About Previse

Previse is a next generation embedded finance platform that uses AI to deliver the future of finance for global B2B commerce. Previse's smart technology and algorithms analyse invoice data to identify invoices that are eligible to be paid instantly. Previse was founded in 2016 by a team of world-class experts in trade finance, AI and enterprise technology. The company counts Augmentum, Bessemer Venture Partners, and Hambro Perks among its financial backers.

Previse's solution is an effective and proven model for early payments that offers game-changing benefits for buyers and suppliers.

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