

FCI Four-corner model ("FCIreverse")

Accounting analysis



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Description of the model

Four parties are involved in an FCIreverse factoring arrangement:

Debtor/Buyer: the party who is liable for payment of the receivables from the supply of goods or rendering of services;

Supplier/Seller: the party who invoices for the supply of goods or the rendering of services;

Import Factor: the party to which the confirmed receivables are assigned by the Export Factor

Export Factor: the party to which the supplier assigns his confirmed receivables in accordance with the factoring contract.

Contrary to regular factoring, reverse factoring is initiated by the Buyer. This allows the Seller to collect on its receivables earlier while reducing the cost as compared to regular factoring as the rate offered by the Export Factor is based on the creditworthiness of the Import Factor. By initiating reverse factoring, the Buyer may be able to negotiate payment terms with the Import Factor which differ from the payment terms of the original invoice. In addition, the Buyer increases its negotiating power with the Seller by being able to offer faster payment through the reverse factoring mechanism.

1. The Buyer commences the relationship by signing an agreement with the Import Factor (usually a bank)
2. The Import Factor on-boards the Buyer (credit check is performed to assess the factoring credit limit the Import Factor is willing to extend)
3. The Import Factor sends a message to the Export Factor asking them to on-board the Seller (KYC, Contract, Provide education, etc.)
4. The Export Factor sends an approval back to the Import Factor agreeing to on-board
5. At the same time, the Export Factor will determine the maximum credit limit for factoring available to the Seller based on the credit risk of the Import Factor (as the Import Factor is the final party responsible for payment)
6. Following an order, the Seller ships the goods to the Buyer and issues invoices. The Buyer records Trade Payable and the Seller Trade Receivable.
7. The Buyer selects invoices for reverse factoring (earlier payment to the Seller) and forwards them to the Import Factor
8. The Import Factor approves the credit of the Buyer in respect of the selected invoices (based on the selected invoices up to a certain limit) and notifies the Seller and the Export Factor of the invoices approved
9. From the list of approved invoices, the Export Factor makes an offer to the Seller to factor invoices for a price
10. If the Seller decides to accept this offer (no obligation), the receivables are transferred to the Export Factor
11. The Export Factor immediately assigns the transferred receivables to the Import Factor
12. The Import Factor issues a confirmation of the invoices assigned, thus accepting the credit risk
13. The Export Factor finances the invoices by issuing a cash advance to the Seller
14. Via the confirmation in step 12, the Import Factor accepts the responsibility for collecting the payment from the Buyer and remitting this payment to the Export Factor
15. The Import Factor settles the outstanding amount with the Export Factor on the agreed due date
16. The Import Factor collects payment from the Buyer while bearing any credit losses thereon.

Throughout this analysis, reference is made to the General Rules for FCIreverse May 2018.

Accounting analysis¹

Seller

Accounting analysis for the seller focuses on whether de-recognition of the factored receivables is allowed under IFRS 9. The seller should follow the de-recognition analysis in IFRS 9.3.2 and IFRS 9 AG B3.2.1 to conclude whether the receivable, and substantially all risks and rewards, have been transferred.

If the Export Factor does not have any recourse against the Seller in connection with the receivables, the Seller derecognizes the receivables from its balance sheet at the moment it receives payment from the Export Factor. Refer to Appendix A for the complete flow of de-recognition analysis under IFRS 9 which has to take place before de-recognition of the asset is possible.

Journal entry

DR Cash

CR Trade Receivables

Export Factor

The Export Factor recognizes a financial asset receivable from the Buyer as factored from the Seller.

Following factoring of the receivables from the Seller, the Export Factor immediately assigns the receivables to the Import Factor. To determine the accounting for this, the Export Factor must also go through the steps of financial asset de-recognition analysis of IFRS 9.3.2 and IFRS 9 AG B3.2.1.

The General Rules for FCI Reverse read as follows:

Article 12 Assignment

- (i) The assignment of a receivable implies and constitutes the transfer of all rights and interest in and title to such receivable by any means. For the purpose of this definition the granting of a security right over a receivable is deemed to be its transfer
- (ii) By reason of the assignment by the Export Factor to the Import Factor of full ownership of each receivable, the Import Factor shall have the right of bringing suit and otherwise enforcing collection and the Import Factor shall have the benefit of all rights of lien, stoppage in transit and all other rights of the unpaid supplier
- (iii) All assignments of receivables must be in writing

Article 15 Definition of credit risk

- (i) The credit risk is the risk that the debtor will fail to pay a receivable in full on the due date of the receivable irrevocably undertaken to be paid by the debtor to the Import Factor and which has been confirmed by the Import Factor.
- (ii) The assumption by the Import Factor of the credit risk on receivables assigned to him is conditional upon his confirmation of such receivables as provided in Article 16.

Assuming that the above articles, in combination with Article 16, mean that all risks and rewards of the receivables are transferred to the Import Factor, the Export Factor should de-recognize these receivables from its balance sheet.

¹ For simplification purposes, the journal entries presented in this analysis ignore the effect of any fees or interest.

Depending of the payment terms, the Export Factor would record either a direct cash receipt in exchange for the receivables or record a receivable from the Import Factor. This is logical also given that the Export Factor initially sets its factoring credit limit by reference to the credit risk of the Import Factor, and not the Buyer.

Journal entry

DR Receivable from Seller
CR Cash

DR Receivable from Import Factor
CR Receivable from Seller

Import Factor

As discussed above, following the FCIreverse mechanism, the factored receivables are assigned by the Export Factor to the Import Factor, which results in de-recognition of the receivables from Buyer and recognition of receivables from Import Factor in the books of the Export Factor.

Article 18 Collection

The Import Factor is responsible for collection of all Confirmed Receivables

Article 19 Agreed Payment Date (APD)

Agreed Payment Date (APD) is the date on which the Import Factor and the Export Factor agree as the payment date by the Import Factor to the Export Factor. The APD may be the due date of the receivable or any date before or after the due date that is proposed by the Import Factor and agreed by the Export Factor.

Article 20 Transfer of Payments

- (i) The Import Factor shall pay to the Export Factor the outstanding balance of such assigned Confirmed Receivable on the APD in the currency of the invoice. Under extraordinary circumstances, if the payment cannot be made in the same currency of the invoice, such payment in different currency should cover the invoice amount in full in accordance with the rate of exchange as quoted by XE.com (as used in edifactoring.com) on the APD.
- (ii) All payments shall be transferred via SWIFT or a similar system.
- (iii) Not later than the day of the transfer the Import Factor shall provide a report showing the allocation of the amount transferred.

Following Articles 12, 15, 18, 19, and 20, assuming confirmation of the respective receivables by the Import Factor following Article 16 has taken place, as at the date of the Interfactor agreement, the Import Factor incurs a contractual right to receive cash from the Buyer (a financial asset) and a contractual obligation to deliver cash to the Export Factor (a financial liability).

The financial asset should be accounted for in line with classification & measurement guidance of IFRS 9. The Import Factor is exposed to the Buyer's credit risk in connection with this asset. Assuming that the asset qualifies for accounting at amortized cost, it should be assessed for impairment at each reporting date. Final credit losses on the asset are absorbed by the Import Factor following its obligation to remit the full payment to the Export Factor regardless of its ability to collect the corresponding amounts from the Buyer.

Financial liability to the Export Factor should be recorded as at the date of receivables assignment as the Import Factor incurs an obligation to pay the Export Factor at an agreed upon due date. The obligation is not contingent on the status of invoice payment by the Buyer and should be accounted for under IFRS 9. Because the liability does not arise from a transaction resulting in an Expense in the Import Factor's P&L, it should not be classified as a Trade Payable and would fall in the category of Bank Debt.

Offsetting criteria of IAS 32 would not be met for this asset and liability.

Accounting for any additional guarantees provided by the Import Factor to the Export Factor follows the same logic as presented under the analysis of the Buyer. If the guarantee pertains to a financial liability recognized by the Import Factor, no accounting entries are required as both relate to the same risk. Otherwise, the guarantee issued should be disclosed in the Import Factors financial statements and accounted for in accordance with IFRS 9.

Journal entry

DR Receivable from Buyer

CR Payable to Export Factor

Buyer

As mentioned above, reverse factoring differs from regular factoring because it is initiated by the Buyer. In regular factoring, the Buyer is often unaware that the receivable has been factored by the Seller and the payment terms remain unchanged.

By initiating reverse factoring, the Buyer may be able to negotiate payment terms with the Import Factor which differ from the payment terms of the original invoice. This and other considerations may amend the nature of the payable on the Buyer's balance sheet requiring reclassification from Trade Payables to Bank Debt.

Although IFRS is silent on this topic, the following items are considered relevant based on available industry literature and practice:

Item	Considerations signalling reclassification to Bank Debt
Payment terms	The Buyer has negotiated payment terms with the Import Factor which are substantially different from the terms of the original invoice. The Buyer can negotiate with the Import Factor about the seniority of the payable as compared to other credits on its balance sheet.
Interest payments	The Buyer is required to pay interest or fees to the Import Bank on payables that have not fallen due.
Credit notes	The Buyer is required to make the full payment to the Import Factor regardless of credit notes subsequently issued by the Seller. The issued credit notes can be applied to future purchases.
Guarantees	The Buyer provides additional guarantees to the Import Factor which puts the Import Factor in a more favourable position than the Seller prior to factoring.
Fees	The Buyer receives a fee from the Import Factor based on factoring volume.
Negotiations	The Buyer is heavily involved in negotiations of the factoring agreement between Supplier and the Factors. This is the case if there is a factoring agreement where the Buyer is a signatory along with the Seller, and the Factors (tri-party agreement or four-party agreement).

FCIreverse factoring does not usually include a modification of payment terms of the original invoice. Thus, in absence of any other relevant considerations listed above, the Buyer would continue to classify the liability as a Trade Payable even though the ownership of the payable has changed from the Seller to the Import Factor.

By virtue of Article 15 and 16 of The General Rules of FCIreverse, the Buyer provides an irrevocable undertaking of payment of a receivable to the Import Factor. If the such an undertaking is provided by the parent company of a group (together the Buyer), it would meet the definition of a financial guarantee under IFRS 9:

A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Thus, the accounting will follow:

- In the subsidiary financial statements, the Buyer records financial liabilities arising from original invoice and any reverse factoring arrangement.
- In the parent company financial statements, the Buyer discloses the guarantee issued on behalf of its subsidiaries and accounts for it in accordance with IFRS 9.
- In the consolidated financial statements, the payables are recorded and the guarantee is not disclosed as it carries the same risk as the financial liability it is connected to (obligation to pay the Import Factor).
- In all cases, requirements for related party disclosures should be considered.

If, in addition, the Buyer pledges certain assets as security for the financial liability, it shall make the required disclosures in this respect.

Regardless of the conclusion reached on classification of these financial liabilities following the considerations listed above, if reverse factoring is a material activity, the Buyer should disclose it in its financial statements in sufficient detail to enable readers to understand its effects on business operations, financial performance, and cash flows.

Appendix A

IFRS 9 – Derecognition of financial assets

