October 2, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board 401
Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: FASB Agenda Request — Disclosure and cash flow statement presentation of supplier finance programs involving trade payables

Dear Mr. Kuhaneck:

We appreciate the opportunity to submit an agenda request to the FASB. Specifically, we request that the FASB provide guidance regarding (1) the financial statement disclosures that should be provided by entities that have entered into supplier finance programs involving their trade payables and (2) the presentation of cash flows related to such programs under Accounting Standards Codification (ASC) Topic 230, *Statement of Cash Flows*.

Background

In recent years, we have seen an increase in companies working with intermediaries to arrange trade payable programs and an evolution in the types of such programs that are offered in the marketplace. While these programs are referred to by a number of names (e.g., structured trade payables, reverse factoring, vendor payable programs, and supply-chain financing), they typically involve (1) a financial institution or other intermediary settling amounts owed to an entity's suppliers of goods or services and (2) the entity settling its associated payment obligations directly with the intermediary. The nature and terms of these programs vary. They include (1) open account platforms that permit an entity's suppliers to elect to sell trade receivables to participating intermediaries and (2) an entity's issuance of negotiable instruments (e.g., bills of exchange or electronic time drafts) to settle invoices. Typically, open account platforms give participating suppliers the option to settle trade receivables by receiving a payment from an intermediary either prior to the invoice date at a discounted amount or on the invoice due date for its full amount. Although the supplier may be receiving payment early, the purchasing entity is not required to settle its trade payable with the intermediary until the original invoice date.

Programs such as those described above offer various potential benefits to the parties involved. For example, these may include (1) the purchaser is able to benefit from vendors' willingness to accept extended payment terms; (2) improved administration for supplier payments for the purchaser as amounts are paid to the intermediary and not to multiple suppliers; and (3) the supplier has increased liquidity with the option to be paid earlier by the intermediary than it would have been paid by the purchaser (the supplier accepting an early payment discount). The early payment discount the supplier may accept from the intermediary is often less than the interest cost the supplier would have incurred had the supplier instead borrowed the amount outstanding under its trade receivable (as the amount of the discount is driven by the credit quality of the purchaser, not the supplier).

In recent years, we have seen an evolution of these types of programs (i.e., trade payable terms). For example, there has been an increase in the average number of days payables outstanding for goods or services for some companies that use these arrangements. Whereas typical payment terms with suppliers historically might have been 60 to 90 days, some entities today seek to negotiate payment terms with suppliers of up to 180, 210, or even 364 days. Suppliers are more likely to accept extended payment terms when the purchaser has arranged a structured payable program that permits the suppliers to monetize their trade receivables before its due date.

While there is no specific guidance in U.S. GAAP that addresses the classification of these programs as trade payables or debt, a general framework has evolved in practice for how to determine the appropriate balance sheet classification. This general framework is based in part on SEC staff speeches at the 2003 and 2004 AICPA National Conferences on Current SEC and PCAOB Developments. Under this framework, the proper classification of structured trade payable arrangements is facts and circumstances driven and reflects the substance of the arrangements (e.g., whether payment terms are customary). If the intermediary's involvement does not change the nature, amount, and timing of the entity's payables and does not provide the entity with any direct economic benefit, continued trade payable classification may be appropriate. If the nature, amount, or timing of its payables changes or the entity benefits from transactions between suppliers and the intermediary (e.g., by receiving fees or rebate payments from the intermediary), however, reclassification may be required. Often the starting point to determine whether the substance of an entity's payables has changed as a result of the structured trade payable arrangement includes evaluating whether the original obligation has been substantially modified or extinguished. In their interpretive guidance, the large accounting firms have identified additional indicators to help determine the appropriate balance sheet classification.

In a speech in 2004, then SEC Professional Accounting Fellow Robert J. Comerford made the following remarks with respect to balance sheet presentation of certain structured trade payable arrangements:

> "As a general rule, the OCA Staff does not believe that it is possible to determine the appropriate accounting for structured transactions simply via reference to checklists and templates. Rather, an entity must perform a thorough analysis of all the facts and circumstances specific to the individual transaction in order to ensure that the entity's accounting for the transaction serves investors well. … [T]his necessitates meeting not just the letter, but the spirit of the accounting literature."

If a trade payable arrangement involving an intermediary must be classified as a borrowing, the entity should consider the associated cash flow statement implications. In a speech in 2005, Joel Levine made the following remarks related to cash flow statement presentation of floor plan financing arrangements:

> The situation addressed by the staff dealt with a transaction similar to the purchase of non-[F] products financed through [FC]. For example, say a dealer purchases [F products] financed under a floor-plan arrangement with [FC]. [FC] pays the supplier directly and then is repaid later by the dealer. In this case, the financing arrangement is not with the supplier, as it was when the dealer purchased [F] products; therefore, it does not represent a trade loan. It represents a third-party financing arrangement. Not a big deal, except that the inventory purchase, an operating activity, has taken place without the dealer physically delivering the cash. Based on the view that the financing entity effectively has acted as the dealer's agent, we concluded that upon purchase of the inventory, the dealer should report the increase in the third-party loan in substance as a financing cash inflow, with a corresponding operating cash outflow for the increase in inventory. Upon repayment, the cash outflow would be reported as a financing activity. Here, the cash flows statement would depict the substance of the transactions - with the end result being similar to the previous example where the net effect on operating cash flows is the amount of gross profit generated.

Entities that recharacterize trade payables as debt may or may not apply the above guidance. The table below summarizes the general statement of cash flows presentation depending on whether the above-referenced guidance is considered applicable.

	Statement of Cash Flows Presentation	
Balance Sheet Classification	**Trade Payable is Derecognized and Debt is Recognized**	**Debt is Repaid**
Debt – SEC speech *is* applied	Operating outflow and Financing inflow	Financing outflow
Debt – SEC speech *is not* applied	Noncash financing transaction	Financial outflow
Debt – SEC speech *is not* applied	No recognition or disclosure	Operating outflow

Generally speaking, because there are no specific disclosure requirements in U.S. GAAP related to these types of programs, there has been limited disclosure of such programs provided in practice. As a result, pressure is placed on the proper classification of structured trade payable arrangement as trade payables or debt in the balance sheet in order for financial statement users to understand the nature of the entity's obligations[1]. Trade payable classification tends to be treated more favorably than borrowings (i.e., financings) in the calculation of financial ratios and for purposes of determining compliance with financial covenants. Accordingly, we believe greater transparency and consistency in disclosures in the financial statements of entities that utilize structured trade payable arrangements such as those described herein is warranted[2].

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[1] The classification on the balance sheet as trade payable or debt generally does not impact the classification of such liabilities as current liabilities since in all cases the obligation is due within one year.
[2] While we would welcome guidance on how to determine if such programs change an

In recent comment letters to registrants, the SEC staff has expressed interest in better understanding quantitative and qualitative characteristics of such arrangements. Specifically, such characteristics include:

- Dollar amounts settled via the arrangement and the balance representative of amounts due to the financial institution/intermediary;
- Analysis supporting classification of amounts settled under the arrangement as trade payables or bank financing, including classification and non-cash disclosure considerations per ASC 230; and
- The arrangement's impact on an entity's payment terms to its suppliers, days payable outstanding, liquidity and risk factors

In addition, rating agencies have called for greater transparency with respect to such arrangements. Such stakeholders have indicated that whether or not these arrangements are classified as trade payables or borrowings on the balance sheet is less important than sufficient disclosure as to the nature, significant terms, and quantitative measures of these arrangements. The FASB should perform outreach of a cross section of users such as lenders and rating agencies to understand their needs regarding differentiation between different categories of short-term payables.

Given the varying nature and substance of these programs, along with the evolving practices and programs involving supplier financing, we acknowledge that it would be difficult for the Board to provide prescriptive guidance as to the proper classification of such arrangements in an entity's balance sheet (i.e., trade payable or debt). However, we believe that with proper disclosure and explicit statement of cash flow classification guidance, users of the financial statements will have a better basis for making informed decisions with respect to the entity's financial position, liquidity, and cash flows. We believe that standard setting by the Board to provide guidance on the presentation and disclosure of the trade payable arrangements discussed in this agenda request would provide greater transparency to users of entities' financial statements.

The appendix to this letter contains a summary of possible alternatives for the Board to consider. Because this is a narrow issue that could be resolved in a short time frame, it may best be addressed by the EITF.

We would be happy to share additional perspectives and suggestions with the Board and FASB staff on the matter discussed in our agenda request. If you have any questions concerning this request, please contact Ashley Carpenter at 203-761-3197, Donald Doran at 908-581-0874, Kevin Guckian at 212-773-1051, or Patrick Garguilo at 212-954-2852.

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entity's trade payables to debt arrangements, we acknowledge that it may be difficult to provide guidance other than indicators. In any event, we believe it is warranted for the Board to provide disclosure requirements to increase the transparency of such programs whether the obligations are classified as trade payables or debt.

Yours truly,

Deloitte & Touche LLP

Ernst & Young LLP

KPMG LLP

PricewaterhouseCoopers LLP

Appendix
Agenda Request —Disclosure and cash flow statement presentation of supplier finance programs involving trade payables

This agenda request is limited to disclosures regarding supplier finance programs and statement of cash flows presentation.

Disclosures

The following are potential disclosure items related to structured trade payable programs:

- A description of the nature and terms of the arrangement
- The monetary amounts settled through the arrangement and amounts due for payables the company understands have been sold
- The classification of amounts under the arrangement on the balance sheet and statement of cash flows

Statement of Cash Flows Presentation

The following views exist for the appropriate presentation of cash flows related to structured trade payable programs involving an intermediary:

- *View A* — An entity should present the activities associated with such arrangements gross within the statement of cash flows. Obligations incurred during the period that have been paid by an intermediary, but not yet paid by the entity, should be treated as a cash outflow from operating activities, with a corresponding cash inflow from financing activities. Any payments of such obligations remitted to the financial institution by the entity during the period shall be presented as financing cash outflows.

  Proponents of View A believe gross presentation within operating and financing sections of the statement of cash flows reflects the respective roles of the entity and nature of the activities. Classification of certain cash flows as financing distinguishes these activities from accounts payable as they are cash flows between the entity and a financial intermediary. Proponents of this view believe such presentation aligns with the 2005 comments provided by Mr. Levine of the SEC staff.

  Note that this view would generally apply only if the obligations have been recharacterized from trade payables to borrowings.

- *View B* — An entity should present the activities associated with obligations incurred during the period that have been paid by an intermediary, but not yet paid by the entity, as a noncash financing activity. Any cash payments of such obligations remitted to the financial institution by the entity shall be presented as a financing cash outflow.

  Proponents of View B believe that when an intermediary pays an entity's supplier and the obligation changes from a trade payable to a borrowing, that transaction meets ASC 230's description of a noncash financing activity. As the entity does not pay cash directly to the supplier, but pays the borrowing to the financial institution, such payment reflects a financing cash outflow. Proponents of this view believe it is consistent, by analogy, with the investor's statement of cash flows presentation of receipt and ultimate payment of beneficial interests in securitized trade receivables.

Note that this view would generally apply only if the obligations have been recharacterized from trade payables to borrowings.

- *View C* — An entity should present the cash flows associated with these arrangements within operating activities. That is, the payments made to the financial institution to extinguish the obligation that arose from the sale of goods or services reflects an operating cash outflow. Accordingly, any payments of such obligations remitted to the financial institution by the entity during the period shall be presented as an operating cash outflow.

  Proponents of View C believe that the nature of the goods purchased or services received should dictate the classification of the associated cash flows. As these arrangements are typically provided by entities to their suppliers of goods and services used in the normal course of business, the classification of the related cash flow activities should be within operating activities. Proponents of this view believe it is consistent with ASC 230-10-45-17(a), which states that operating cash outflows include "[c]ash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods."

  Note that this view would apply if the obligations are not recharacterized from trade payables to borrowings. This view is an alternative when the obligations have been recharacterized from trade payables to borrowings. Application of this view in all circumstances would alleviate the pressure on companies to determine whether these obligations are classified as trade payables or borrowings.