GAAP

UPDATE SERVICE

Volume 22, Issue 22
November 30, 2022

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Supplier Finance Program Disclosures

PRONOUNCEMENT

Liabilities—Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations (ASU No. 2022-04)

Executive Summary

Companies often offer their vendors the option to be paid a discounted amount prior to the contractual due date of the vendor's invoice. In a typical supplier finance program,[1] vendors who accept this advanced payment option are paid by a third-party intermediary, such as a bank. At a later date, the company remits the full amount of the vendor invoice to the intermediary.

US GAAP does not address the accounting for supplier finance programs. In addition, the specific terms of these programs vary. As a result, the classification of the liabilities associated with these programs and the level of disclosure varies. This has led investors to ask for more information about these arrangements.

The FASB has issued new guidance requiring qualitative and quantitative disclosures to assist investors understand the effect of these programs on a company's working capital, liquidity, and cash flows. It does not address how these programs should be accounted for or where the liabilities should be classified.

The new rules apply equally to public and private companies.

Most of the new disclosures are required for fiscal years beginning after December 15, 2022. However, some disclosures can be deferred for an additional year. Early adoption is permitted. Transition is generally retrospective.

Highlights

Supplier finance programs, also referred to as reverse factoring or structured payables arrangements, allow companies to give vendors the option to be paid early while simultaneously delaying payment of those same trade payables. This seemingly contradictory outcome is achieved by inserting a third-party intermediary into the supplier payment cycle.

These arrangements can be complex. However, a simple supplier finance program works as follows:

- Company C purchases goods from Vendor X. Payment terms are net 90 days. Company C offers Vendor X the option to be paid a discounted amount in 45 days. Vendor X accepts the optional terms.
- Bank A, acting as an intermediary for Company C, pays Vendor X's approved invoice at a discounted amount in 45 days, as per the optional payment terms.
- Company C pays Bank A the full amount of Vendor X's invoice on its original due date.

US GAAP provides no explicit guidance on the accounting for supplier finance programs. Depending on the terms of the arrangement, the company purchasing the goods might classify its obligation to the third-party intermediary as short-term debt or as trade payables.

Previously, US GAAP was also silent regarding disclosure. Although companies typically provided some disclosure about their supplier finance programs, the nature and extent of the disclosure varied. Investors expressed concern about the lack of transparency and comparability.

The FASB's new standard, *Liabilities—Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations* (ASU No. 2022-04) addresses this lack of transparency by requiring the following disclosures by a company who enters into these programs:

- Key terms of the program.
- Amount of the obligation at the balance sheet date.
- Where the obligation is presented on the balance sheet.
- Rollforward of the obligation.

The new disclosures are required in the annual financial statements of both public and private companies. Certain disclosures are also required in interim periods.

The effective date and transition depend on the specific disclosure:

- The effective date for all disclosures other than the rollforward of the obligation is fiscal years beginning after December 31, 2022, including interim periods within those fiscal years. Transition is retrospective to all periods for which a balance sheet is presented.
- The effective date for disclosure of the rollforward of the obligation is fiscal years beginning after December 15, 2023. Transition for this specific disclosure is prospective.
- Early adoption is permitted.

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Analysis

Background

Supplier finance programs have existed for at least 20 years, as evidenced by SEC staff speeches about these arrangements in 2003 and 2004.[2]

The exact terms of a supplier finance program differ widely. However, the general outline of such a program is as follows:

- A company and a third-party intermediary have a contractual arrangement that facilitates payment of the company's vendors.
- The contract's terms require the third-party to pay a qualifying vendor's invoice prior to its original due date at a discounted amount. The original due date for the invoices in the program may be the same as other trade payables but is often extended.[3]
- At a later date, the company pays the third-party the full amount of the invoice. The company's payment is typically on the original due date of the invoice but need not be.
- The spread between the discounted amount the third-party pays the vendor and the amount it receives from the company compensates the third-party for its services. The company may also pay service fees to the third-party.

A supplier finance program differs from an arrangement in which a supplier factors its receivables in that the buyer of the supplier's goods or services (a) is involved in setting up the program, and (b) determines which invoices qualify for payment.

Current Accounting

The SEC Staff's speeches suggest that the company's obligations under these arrangements may represent short-term debt. However, these programs have evolved over the years and have different structures.

In the absence of specific guidance in US GAAP, practice has developed a framework to determine the proper classification of the company's obligations to the third-party intermediary.

> "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."[4]

Thus, the accounting for supplier finance arrangements and the resulting balance sheet classification of the company's obligations depends on the specific terms of the arrangement.

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In some fact patterns, the company presents its obligations as short-term debt. In other fact patterns, the obligations are classified as trade payables.

Prior Disclosure

US GAAP provided no guidance on the disclosure of these arrangements. As a result, disclosure of these programs in the notes to the financial statements has been limited.[5]

In 2019[6] and 2020,[7] the SEC staff emphasized the need for more robust disclosures in MD&A regarding the use of these programs and their effect on a company's liquidity and operating cash flows.

New Disclosure Requirements

Scope

The scope of the new standard is limited to footnote disclosures. It does not address the recognition, measurement, balance sheet or cash flow statement classification of transactions under supplier finance programs.

The new rules define a supplier finance program as one in which (a) the company enters into an agreement with a finance provider or intermediary; (b) the company provides the finance provider or intermediary with confirmation of valid supplier invoices; and (c) the company's suppliers have the option to request early payment from a party other than the company.

To help companies identify these types of programs, the guidance notes that an irrevocable commitment by the company to pay a party other than the supplier for a valid invoice is a non-determinative indicator of a supplier finance program.[8]

The definition of a supplier finance program is intentionally broad. But the Board does not intend for it to encompass traditional credit cards, payment processing, and normal factoring.[9]

Observation – Proposed Disclosures under IFRS

In November 2021, the International Accounting Standards Board (IASB) issued a proposal to require disclosure of supplier finance programs in annual financial statements prepared under International Financial Reporting Standards (IFRS).[10]

Although the IASB's proposal would require the same disclosures as US GAAP, companies would be required to also disclose:

- The amount of the obligation at the end of the period for which suppliers have already received payment;
- The range of payment due dates for obligations under the supplier finance program; and
- The range of payment due dates for trade payables that are not part of a supplier finance arrangement.

The IASB recently began its redeliberations.[11]

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Disclosures

Regardless of whether the company classifies its obligations under these programs as short-term debt or trade payables,[12] the following disclosures are required in the annual financial statements of companies that have entered into supplier finance programs:

- **Key terms:** Key terms of the program include, but are not limited to, a description of the payment terms, including payment timing and the basis for its determination, and assets pledged as security or other forms of guarantees related to the company's commitment to the third-party intermediary.
- **Amount outstanding:** Disclose the amount of obligations outstanding at the end of the year that have been confirmed as valid to the third-party intermediary. This represents the amount of valid invoices the company has placed into the program that remain unpaid by the company.
- **Balance sheet classification:** Disclose the balance sheet line item that includes confirmed obligations under the program that remain unpaid by the company. If the amounts are presented in more than one balance sheet line item, the company should disclose the amount included in each line item.
- **Rollforward:** Provide a rollforward of the confirmed obligations showing:

    — the amount of confirmed obligations outstanding at the beginning of the year,
    — the amount of confirmed obligations added during the year,
    — the amount of confirmed obligations settled during the year, and
    — the amount of confirmed obligations outstanding at the end of the year.

The amount of the obligation being disclosed as of the beginning and end of the year is the total amount of confirmed (i.e., valid) supplier invoices that are unpaid, from the perspective of the company. Amounts paid by the finance provider to suppliers is not separately disclosed.

Said differently, a company discloses its total obligation under the program at the balance sheet date. That obligation consists of (a) valid invoices the finance provider has paid to suppliers that remain unpaid by the company, and (b) valid invoices that the finance provider has not paid. There is no requirement to disclose the amount of valid supplier invoices that the finance provider has paid but remain outstanding at the balance sheet date.[13]

Observation – Effect on Private Companies?

The new standard does not provide any exceptions or practical expedients for private companies. The Board concluded that the new disclosures would provide users of private company financial statements with relevant information.

Nonetheless, the effect of the Proposal on private companies is likely to be limited. The FASB's Private Company Council[14] and the AICPA's Private Company Practice Section[15] noted that private companies generally do not enter into supplier finance programs.

Companies that have more than one supplier finance program are permitted to aggregate disclosures if the programs are not substantially different.

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Public companies would continue to include in MD&A any appropriate information about the effects of these programs on liquidity and cash flows.[16]

The final standard requires some limited disclosures in interim periods. Specifically, the company must disclose the amount of confirmed obligations outstanding as of the end of the interim period.[17]

Effective Date and Transition

The FASB adopted a two-tiered approach to the effective date and transition of the new disclosures in order to give companies more time to accumulate the information to be presented in the rollforward.

Effective Date

The effective date for all disclosures other than the rollforward of the obligation is fiscal years beginning after December 31, 2022, including interim periods within those fiscal years.

The rollforward is not required until fiscal years beginning after December 31, 2023.

Early adoption is permitted.

Transition

Except for the rollforward, transition is retrospective. A company with a calendar fiscal year that presents comparative annual financial statements would therefore initially disclose the required information related to key terms, amounts outstanding and balance sheet classification for its years ended December 31, 2023 and December 31, 2022.

Transition for the rollforward is prospective. Thus, upon adoption, a company is required to present the rollforward for the most recent year only. In subsequent years, the rollforward is presented on a comparative basis.

Observation – Changes from the Exposure Draft?

The final standard is substantially the same as the exposure draft.

Some might view this as surprising considering the strenuous objections raised by the investor and user communities. Users were unanimous in their view that the disclosures outlined in the Exposure Draft would not provide sufficient information to determine how the programs are used.[18] However, the Board concluded that the type of information investors were seeking (amount of obligations the finance provider had paid to the supplier and/or the average payment term, in days, for suppliers in the program) could not be provided on a cost-effective basis.[19]

One change made by the Board was to require disclosure of the outstanding obligation in interim periods. This responded to investor (and some Board member) concerns that quantitative information on a quarterly basis is important to a user's analysis.[20]

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Endnotes

1. The FASB uses the term "supplier finance programs" to describe a broad category of financing arrangements that can be referred to by various names, such as reverse factoring, payables finance, structured payables arrangements, supply-chain financing, and vendor payable programs. The specific terms and conditions for these arrangements can vary widely.

2. See SEC Staff Speech by Robert Comerford at AICPA National Conference on December 11, 2003, https://www.sec.gov/news/speech/spch121103rjc.htm and December 6, 2004. https://www.sec.gov/news/speech/spch120604rjc.htm

3. For example, suppliers that normally expect payment in 30 to 45 days might see payment dates of 75 to 90 days in a supplier finance program.

4. See the October 2, 2019, agenda request to the FASB from the four large accounting firms (Deloitte, EY, KPMG, and PwC). https://fasb.org/page/showpdf?path=AR-2019.UNS.020.BIG%204%20ACCOUNTING%20FIRMS,0.pdf

5. Ibid.

6. As noted in CCH's discussion of the AICPA National Conference in December 2019, "Corp Fin urged companies to consider their disclosures related to supplier finance arrangements. In some cases, companies are using these arrangements to increase liquidity or operating cash flows. These facts should be discussed in MD&A. This should include trends on whether these arrangements will materially impact future liquidity and whether these arrangements are being used for this or other purposes. Limits on this strategy should also be considered." https://www.accountingresearchmanager.com/#/combined/71F00F903E378FC7652584CE001B8E08/regulatory/sec-practice/08-sec-staff-views/aicpa-national-conference-on-current-sec-and-pcaob-developments-2019/arm-secprac-spcht201947overview-overview.

7. See the SEC Division of Corporation Finance CF Disclosure Guidance, Topic 9A related to COVID-19 Disclosure Considerations Regarding Operations, Liquidity and Capital Resources dated June 23, 2020. https://www.sec.gov/corpfin/covid-19-disclosure-considerations.

8. See paragraph BC16 in the Basis for Conclusions of ASU No. 2022-04. The text of the standard does not use the word "irrevocable". Rather, it states that the amount of the invoice to be paid is not subject to "offset, deduction or any other defenses." In short, the company has an irrevocable commitment to the third-party intermediary to pay a valid invoice.

9. See paragraph BC18 in the Basis for Conclusions of ASU No. 2022-04.

10. IFRS Standards Exposure Draft, Supplier Financial Arrangements: Proposed amendments to IAS 7 and IFRS7. Comments were due March 28, 2022. https://www.ifrs.org/projects/completed-projects/2023/supplier-finance-arrangements/exposure-draft-and-comment-letters/#view-the-comment-letters/

11. For more information about the feedback the IASB received, refer to the handouts from the July 18-21, 2022 IASB meeting. https://www.ifrs.org/news-and-events/calendar/2022/july/international-accounting-standards-board/

12. See paragraph BC17 in the Basis for Conclusions of ASU No. 2022-04.

13. See paragraph BC32 in the Basis for Conclusions of ASU No. 2022-04.

14. See paragraph BC22 in the Basis for Conclusions of AU No. 2022-04.

15. See comment letter from the AICPA Private Companies Practice Section (March 21, 2022).

16. See footnotes 6 and 7.

17. This is a change from the Exposure Draft. As proposed, interim disclosures would have been required only if there were a material change from the previous year-end.

18. See the GAAP Update dated April 30, 2022 (Volume 22, Issue 8), *Supplier Finance Programs Disclosures (Proposal),* for discussion of feedback received on the Exposure Draft.

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[19] See the discussion in paragraph BC32 in the Basis for Conclusions for ASU No. 2022-04.

[20] As noted in paragraph BC26 in the Basis for Conclusions of the Exposure Draft, three Board members disagreed with the majority conclusion that no interim disclosures be required. In their view, (a) companies indicated that it would not be difficult or costly to obtain this information at the end of a quarter, and (b) users of financial statements said that the rollforward and outstanding amount of the obligation at interim periods would be a significant benefit.

About the Author

This edition of the *GAAP Update Service* was authored by highly credentialed, seasoned CPAs at Financial Reporting Advisors, LLC. Located in Chicago, the firm provides accounting advisory, SEC reporting, litigation support and dispute resolution services. Resumes and more information can be found at https://www.finra.com/

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