Financial Accounting

Companies Set to Shine Light on Greensill-Style Financing

By Nicola M. White

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- FASB to release proposal requiring new disclosures
- To focus on key payment terms for supply chain financing

Companies could soon have to shine a light on a common financing technique that flatters their cash flows but stays hidden from investors and analysts.

Accounting rulemakers on Wednesday voted to require U.S. companies to reveal the key terms of their supply chain financing, a tool that allows them to spread out payments to suppliers through arrangements with banks and financial institutions. Many companies use the technique but most don't say they do.

That's a problem for investors and analysts. While they don't fret if a well-capitalized, high-credit company uses the typically risk-free financing, they worry about businesses with shaky credit delaying their bills and masking cash-flow problems. The implosion this spring of Greensill Capital, a financial firm that arranged supply chain financing but lent to risky customers, highlighted the information gap and put pressure on accounting rulemakers to take action.

"If something goes away, like Greensill, or companies lose this financing, it could be trouble," said Shripad Joshi, senior director at S&P Global Ratings.

Under FASB's plan, to be released for a 90-day comment period, companies would have to disclose the key terms of their programs, what they paid during the reporting period, outstanding balances, and describe where the amounts are presented in the balance sheet. They'd have to show comparable information from prior periods in a method accounting rulemakers call retrospective adoption of new accounting requirements.

"The most important output of this is taking out mystery of whether these programs exist and their size," FASB Chairman Richard Jones said during the meeting.

Analysts will be closely watching what FASB actually asks companies to reveal. Analysts have asked FASB to make sure companies present details with proper context so they can understand how material the arrangements are and any significant changes.

FASB also has to decide if the details should be required on an annual or quarterly basis. A majority of board members said they favored requiring the disclosures only once per year but agreed to leave it as an open question in the proposal.

Annual disclosure alone might deprive investors of potentially useful information, because supply chain financing is typically a short-term arrangement.

Reverse Factoring

Large banks like Citigroup Inc. and JPMorgan Chase & Co. provide such financing—referred to as reverse factoring in some instances—but financial technology companies like Greensill are becoming more common in the market. Under the programs, suppliers submit bills to the financial intermediary, which pays the invoice at a slightly lower price than the full value of the bill. The financial institution then collects the full amount of the invoice from the company at a later date, profiting on the difference.

Companies and suppliers consider these programs win-wins for their bottom lines. Suppliers get paid faster, companies get extra time to pay bills, and the financial institutions profit.

“Reverse factoring is not the boogeyman that people are talking about,” said Ben Lourie, associate accounting professor at the University of California at Irvine Paul Merage School of Business.

But prolonged payback terms can flatter company cash flows, particularly if the payback terms stretch from 90 to 180 days or more and companies don’t say anything, Lourie said.

“Given current lack of transparency, it does enable companies to disguise precarious financial situations because there just isn’t disclosure,” said Elizabeth Chuk, associate professor at the University of California at Irvine.

Regulators like the U.S. Securities and Exchange Commission have increased their scrutiny of companies using the financing to extend payment terms. In a sign of the heightened scrutiny, the market regulator has sent letters to Keurig-Dr. Pepper Inc., Boeing Co., Coca Cola Co., Procter & Gamble Co., and Graphic Packaging Holding Co. asking them to explain whether they use supply chain financing and to share the basic terms of the arrangements.

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