The Limitations of Supplier Finance Program Accounting Disclosure for Investors

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Executive Summary

The use of Supplier Finance Programs (SFPs) may alter financial condition of a company. SFPs reduce access to bank funding as they utilize financing of the company's bank group providing committed credit and they may increase debt. The Financial Accounting Standards Board's (FASB) new supplier finance regulations do not require filing companies to disclose the information necessary for investors to evaluate whether a SFP used by the filer should be accounted for as debt or accounts payable. The new accounting standards also do not require filers to provide the information necessary to evaluate how an SFP has changed the prospective solvency of the company, nor do they collect the necessary detailed information to enable investors to compare companies to one another. Further, FASB does not require a filer to provide details on their access to bank credit.[3]

FASB's SFP disclosures are of limited benefit to investors unless financial statement filers voluntarily provide supplemental information not currently required by the standards.[4] The requirements are limited to the gross amount of the confirmed SFP liability and identifying where the liability is recorded on the balance sheet, as well as periodic "roll forwards" of confirmed amounts and an unstructured description of the program. As such, analytical insights from filer disclosures are highly limited creating challenges for investors when evaluating the nature of a company's accounts payable, accounts receivable, cash, and access to contractual funding that could help a company bridge any gaps in their financing operations. Without additional regulatory disclosure regarding SFPs and access to credit, accurately assessing a company's financial condition remains difficult.

In this paper, we explore the benefits derived from SFPs, analyze the voluntary pre-FASB rule implementation disclosures of two competitor companies and provide context for important missing disclosures that are necessary to evaluate the financial condition of companies.

1. Framing the Problem

There is little duller in life than accounting except, possibly, reading about it. Nevertheless, accounting standards, and their attendant financial reporting, are important and changes to standards can exert significant influence on something of great importance—money. Changes that

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[1] Fermat Capital Management, LLC

[2] Pacific Life Insurance Company

[3] See: https://tax.thomsonreuters.com/news/u-s-accounting-rulemaker-drops-project-to-simplify-debt-classification-rules/

[4] See: https://www.fasb.org/document/blob?fileName=SPLYCHN.ED.011.FERMAT_CAPITAL_MANAGEMENT_LLC_ADAM_L._DENER.pdf

alter the flow or perception of the generation of cash, lead to meaningful outcomes reflected in how incentives and behaviors change for many, including for company management.

In September 2022, the Financial Accounting Standards Board (FASB) approved new requirements for all filers of financial statements. FASB is the standards development body authorized by the U.S. Securities and Exchange Commission (SEC) to revise and/or develop new accounting reporting standards which the SEC oversee. The SEC supervises the Public Company Accounting Oversight Board which oversees auditors, authorizes, and supervises the Nationally Recognized Statistical Ratings Agencies (NRSROs, better known as the ratings agencies) and also enforces financial reporting, among other functions. The new disclosure requirements now allow investors to have more insight into certain types of liabilities to be disclosed under accounts payable heretofore unavailable.[5] In this paper we focus on the disclosure requirements specifically around Supplier Finance Programs or SFPs and related standards.[6]

SFPs are liabilities that are the result of three commercial agreements among three different parties which link three different contracts:[7]

1. An agreement between a debtor (buyer) and a creditor (supplier), with an underlying commercial contract to purchase goods between the buyer and supplier,
2. An agreement between the debtor and typically its bank regarding the provision of the supplier financing through a SFP to suppliers of that buyer and,
3. That bank's agreement with certain suppliers identified by the sponsoring buyer or, in other words, a contract to purchase the accounts receivable of the supplier related to that buyer/bank agreement.

Together the agreements—sometimes also called "supply chain finance" or "reverse factoring"—collectively enable the bank working with a debtor to offer suppliers an opportunity to sell and discount their trade account receivables for that debtor. For the debtor, through this arrangement, SFPs are a technique that enables that buyer to structure maturity dates of future accounts payable through coordinating certain account payables activities with its suppliers in conjunction with a finance agent—predominantly banks—and with bank funding. In exchange for waiving its commercial rights to potentially reduce payment to the supplier, as well as to fix a specific date for payment, the bank in question offers a competitive financing cost to the debtor likely reflective of the debtor's borrowing cost, with the bank thus treating the SFP as a debt facility of the debtor. From an accounting perspective, the debtor's commercial rights to reduce payables amounts are already recorded in the balance sheet, though not observable, as a contra reserve account to inventory (that was acquired) and the corresponding payable for it reflects the buyer's commercial rights to return acquired inventory that has some type of defect or that is unsold. That waiver still

[5] Similar rules will be implemented by the International Accounting Standards Board (IASB) which we do not address in this paper.
[6] See here for FASB's definition and the associated accounting standards documents:
https://www.fasb.org/page/PageContent?pageId=/projects/recentlycompleted/disclosure-of-supplier-finance-program-obligations.html
[7] See Figure 1 in Appendix.

enables the debtor to recover those amounts in future transactions with that supplier. SFP arrangements provide greater certainty to all parties regarding the amounts and dates for those supplier's payments, and—in conjunction with a possible preferential financing rate offered by the bank—often allows the buyer to negotiate preferential commercial terms with suppliers, including longer payment terms.

Accounting guidance broadly defines a debt arrangement as one that provides a lender with a contractual right to receive consideration and a borrower with a contractual obligation to pay that consideration on demand or on fixed or determinable dates. (Under contract law, consideration is a promise, performance, or forbearance bargained by a promisor in exchange for their promise. Consideration is the main element of a contract. Without consideration by both parties, a contract cannot be enforceable.) SFPs are complicated arrangements that have potential debt-like characteristics. As noted above, they involve three contracts among three parties, as opposed to one contract under a typical debt arrangement between two parties. SFPs would be classified debt if the debtor exerted influence or control over the consideration provided between the bank and supplier under the bank's purchase contract for the accounts receivable, with consideration possibly including discount rates, amounts, or arrangements that restrict what the bank could do with that asset, including who to sell it to. To know whether to classify an SFP appropriately as either debt or payables, one would need to know whether such characteristics exist in the arrangements.

Unlike traditional leverage, defined as using borrowing measured as debt in ratio to equity, SFPs cannot be easily measured, but can be observed through acknowledgement of their use and through payables settlement trends. Enabling longer terms of payment from how they had been structured previously may remain in perpetuity unless the buyer and supplier agree to shorten those terms in the future. Such techniques are not easily measured, but—as they lengthen liabilities to extend maturity—they can have an impact on the financial condition of a company as they are effectively "leveraging" the balance sheet's equity. Similar techniques may also be "accelerating", which for the purposes of this paper means the faster collection of accounts receivable but can also include other impacts related to inventory acquisition timing. While they can favorably impact profits, to date no uniform measures exist to quantity the use of these techniques in financial statements and, therefore, evaluating their potential impact on the financial condition of a filer. Problems have arisen with individual companies, including Carillion, Abengoa, Liberty, and Americanas, that were reported to use SFPs. Collectively, leverage, leveraging and acceleration for nonfinancial corporations has risen across multiple measures over the past decades. Yet, these techniques are insufficiently disclosed and are not easily observable from the financial statements, despite the profound potential consequences they can have on companies and on investors, particularly in times of market stress events.

Before FASB's new accounting rules, no written guidance existed on how to adequately account for SFPs save for a series of speeches from the SEC Office of Chief Accountant (which supervises FASB) in 2003 and 2004 suggesting that an examination of the totality of the arrangements—the three contracts—is necessary in order to evaluate treatment as accounts payable or debt and

encouraged, "preparers and auditors to take a close look at the roles, responsibilities, and relationships of each party to a structured payable transaction…Taking all of this into account, does it still seem appropriate that amounts payable to a financial institution be classified on the balance sheet as a trade payable?"[8]

Accounting rules cannot and do not address the unique nature of a corporation's supplier or customer relationships. Commercial arrangements between a buyer and seller are complex, vary widely, and reflect the situational needs of those parties. They are also dynamic and carefully managed with important relationships considerably nurtured. Indeed, commercial supply and sales arrangements can be colorful and multidimensional and managing commercial relationships is one of the most critical activities of a corporation. Accounting for them, however, is black and white, one dimensional and anodyne. FASB's new rules enable financial statement users to identify the existence of SFPs and analyze the relative size of a debtor's usage of such arrangements. They will also enable a user to understand any indicative lengthening of overall payment terms, as a SFP description is required to be provided by the company filing the statements. The new rules, however, fall far short of addressing investor needs.[9]

The new disclosures do not require any information provision that would enable a user of the statements to evaluate whether the payable liability should be recorded as debt, meaning that no reliable mechanism exists to adjust the financial statements appropriately or to evaluate the possible impacts of an SFP on financial condition of the filing company. Regarding a company's receivable assets—where companies may be selling their accounts receivable under a customer's SFP—filers are currently only required to disclose material sales of trade receivables, an arrangement often called factoring. To assess the impact of such arrangements on the financial condition of the filer, investors should also be able consider the possible collection of receivables under another debtor's SFP(s), however, this disclosure is not required under the new rules.

This limited scope and quality of required disclosures creates challenges for investors when evaluating the nature of a company's accounts payable, accounts receivable, cash and access to contractual funding that would help a company bridge any gaps in their financing operations. Further, without this disclosure, corporate management incentives to generate returns in the form of enhanced cash flow—likely coupled with dividend and stock repurchase—represents a possible trade off in corporate stewardship. In the corporate governance framework, corporate cash, the ability to generate additional cash in a predictable and timely manner, and the ability to quickly finance cash deficits whenever they arise are important stewardship functions. To understand corporate reductions in available cash, for whatever reason, requires additional disclosure on the use of SFPs and other credit facilities contractually available to fund gaps. Further, while SFPs have benefits for filers, they also reduce bank financing availability for them as debtors. Investors need to

[8] From: https://www.sec.gov/news/speech/spch121103rjc.htm
[9] For previous comments on this issue see:
https://www.fasb.org/document/blob?fileName=SPLYCHN.ED.011.FERMAT_CAPITAL_MANAGEMENT_LLC_ADAM_L._DENER.pdf and https://www.fasb.org/document/blob?fileName=SPLYCHN.ED.001.ACLI_MIKE_MONAHAN.pdf

assess the suitability of all borrowing facilities that are maintained and accessed, including that of larger bank facilities given overlap in bank groups, to ensure a filer has adequate access to funds on short notice.

In this paper, we explore the benefits derived from SFPs, analyze the voluntary pre-FASB rule implementation disclosures of two competitor companies and provide context for important missing disclosures that are necessary to evaluate the financial condition of companies.

2. The Pros and Cons of Supplier Finance Programs for Debtors and Investors

SFP usage is believed to be growing, although evidence for that growth is purely anecdotal as there has been no financial statement disclosure requirement until now. As already mentioned, these transactions can help companies negotiate longer payment terms with suppliers which enables corporate leveraging through increasing available cash while simultaneously increasing accounts payable. Other trade finance techniques allow companies to hedge assets, enhance asset quality or sell their trade receivable assets.

For banks, purchasing SFP receivables is desirable as the corporate debtor's involvement leads to risk reduction that otherwise would not be available if those receivables were purchased directly from suppliers without the support of the debtor. Given that significant risk has been mitigated through the SFP structure, the receivables purchased are a conservative short-term asset for a bank. In prior research we have written about supply chain financing and its suitability for investment as a high quality, short duration strategy particularly desirable in dynamic interest rate environments.[10]

As noted above, the economic reasons that debtors engage in these transactions is to gain both a financial and an accounting benefit. The financial benefit is that they can negotiate better commercial terms, including longer payment terms which have the financial impact of delaying payment by extending the commercial contract terms with the supplier. The arrangements may offer the supplier an inducement, such as the ability to discount those receivables with a nominated finance agent. No matter the arrangement, longer payment terms are the result of commercial debtor-creditor negotiation, but longer payment terms alone are not evidence that a SFP is being used.

There are also significant benefits for debtor accounting. Recorded as payables, investors typically treat trade payables (and receivables) as working capital, as do the auditors and rating agencies analytically. Given this reality, the shift to longer payables, regardless of whether they are discounted under a supply chain finance arrangement or not, would likely see the corporation treating these liabilities as accounts payable. Investors typically treat debt more punitively than working capital overall.

[10] For an overview of such investment strategies see: https://www.fcm.com/confirmed-trade-receivable-investments.html

Delaying a liability payment by one day represents 0.28% of a year (under a 360-day assumption). However, under accounting rules such a difference is immaterial as any liability settlements within the year are recorded as “current” and anything beyond a year are recorded as “long term”. With low interest rates, the benefit of a few days delay for the debtor and the effective cost to the creditor is low, but under higher interest rates that benefit and cost, respectively, is much higher. In early 2020, shortly after FASB began the SFP project that led to the new requirements, the Effective Fed Funds Rate was reduced to 0.25% due to the COVID Financing Crisis which now, as of this time of writing this paper, is approaching 5.00%. The benefits from delay of payment and faster collection increase as interest rates rise, as well as when rates are high. Consequently, the impact of choices and trade-offs made by companies about how to respond to their cash needs are greater as interest rates rise—both for nominal and real rates—as well as when rates are higher.[11]

One other principal benefit of SFPs is there is no interest rate charge to the debtor—the debtor has a fixed price for the underlying goods represented by the payable and the creditor has the embedded option to discount its receivable using the prevailing interest rate under the SFP thus fixing their real rate cost of funds. These characteristics of SFP arrangements are desirable to all three contract parities as they—the buyer, supplier, and bank—hedge economic risks and costs with the principal benefits of 1) accessing less expensive funding for the supplier, 2) extending payables for the debtor and 3) generating an attractive asset with low risk for the bank.

While these features are desirable for the parties involved, they may also mask information about the debtor’s financial condition, which is a concern important to investors. Without additional disclosures—which would need to be voluntarily given the limited FASB required disclosures—investors cannot accurately compare similar companies to one another, they cannot assess whether disclosed SPFs are debt, nor can they assess the scope of a debtor’s bank relationships and whether a bank has increased its relative creditor positioning compared to other creditors. Critically, without supplemental disclosures on SFPs, the ability of the debtor to pay its obligations is masked. In the following section we highlight some of the challenges investors face when assessing companies use of SFPs as a result of limited disclosures.

3. SFP Disclosure Examples: The Pepsi Challenge

Users of financial statements tend to analyze individual companies alongside similar companies and, as such, The Coca-Cola Company and PepsiCo are often compared. In 2020 and 2021, PepsiCo and Coca-Cola made voluntary disclosures about their SFP usage and in the case of Coca-Cola, they also made disclosures as a result of a specific request from the SEC in 2020. These recent voluntary disclosures about their respective SFPs, made prior to the new FASB rules, however, are inconsistent with one another. Traditional analysis of those disclosures would lead investors to miss important points and potential impacts of these SFPs on the respective financial condition of each,

[11] Although calculating “real” interest rates has the added complexity of using forward estimates of future rates for interest and inflation.

as discussed below. The new FASB rules will not do anything to address these existing gaps in disclosure from these companies.

Days payable outstanding (DPO) measures the average length of time to pay suppliers and is calculated by using the outstanding accounts payable balance as a function of cost of goods sold from the same reporting period, with accounts payable adjusted for the number of days in the reporting period (given accounts payable is a closing balance on the balance sheet while cost of goods sold is the income statement expense for that reporting period). Days sales outstanding (DSO) reflects a similar calculation of receivables to sales. Overall, at an individual company level, DPO and DSO are standard working capital measures, allowing for observation of trends in terms of paying slower and/or collecting faster. An analysis of DPO demonstrates a lengthening of payables by Coca-Cola versus PepsiCo (see Figure 2) and trends in DSO demonstrate a shortening of receivables by Coca-Cola versus PepsiCo (see Figure 3). On an absolute basis Coca-Cola has ~130 days payable outstanding and PepsiCo has ~ 90 days payable outstanding, with Coca-Cola's DPO almost doubling over the past decade while PepsiCo's DPO increased by only half over the past decade (see Figure 2). On a trended basis, Coca-Cola has effectively halved their DSO whereas PepsiCo's DSO has increased by ~20% (see Figure 3). Together the data shows that Coca-Cola leveraged and accelerated more than PepsiCo over the past decade. On an absolute basis, however, both companies have similar amounts of cash on their balance sheets, although Coca-Cola has roughly half the annual sales of PepsiCo ($42 Billions vs. $86 Billions).[12]

However, an analysis of the largest customers and suppliers of both entities suggests that these trends in payable leveraging and receivable accelerating do not simply reflect differences in the working capital operations, but rather the nature of their customer and supplier relationships.[13] In the case of Coca-Cola, its supply chain and customer base is made up of related party entities (see Figure 6). PepsiCo—which differs given its provision of snack foods in addition to beverages, beverages being Coca-Cola's sole business—has direct relationships with third parties as suppliers and customers (see Figure 7). Given these differences it is difficult to compare their supplier and customer bases and what terms might be negotiated with those parties and therefore how those terms can ultimately have an impact on financial condition.

With regard to another important element contributing to financial condition each company's access to credit facilities and, specifically, their access to committed bank credit also differ. SFPs utilize a bank credit facility of the debtor, thus the amounts outstanding under these credit facilities use potential credit needed by the debtor. From Coca-Cola's 2021 10-K, they note that,

> "As of December 31, 2021 and 2020, the Company also had $845 million and $854 million, respectively, in lines of credit, short-term credit facilities and other short-term borrowings that were related to our international operations. In addition, we had $9,972 million in unused lines of credit and other short-term credit facilities as of December 31, 2021, of which

[12] See Figures 4 and 5, Cash, Dividends and Stock Buybacks in Appendix.
[13] See Figures 6 and 7 in Appendix.

> $8,060 million was in corporate backup lines of credit for general purposes. These backup lines of credit expire at various times from 2022 through 2027. There were no borrowings under these corporate backup lines of credit during 2021. These credit facilities are subject to normal banking terms and conditions. Some of the financial arrangements require compensating balances . . ..”[14]

PepsiCo’s 2021 10-K revealed that,

> “We entered into a new five-year unsecured revolving credit agreement (Five-Year Credit Agreement), which expires on May 28, 2026. The Five-Year Credit Agreement enables us and our borrowing subsidiaries to borrow up to $3.75 billion in U.S. dollars and/or euros, including a $0.75 billion swing line sub facility for euro-denominated borrowings permitted to be borrowed on a same-day basis, subject to customary terms and conditions. We may request that commitments under this agreement be increased up to $4.5 billion (or the equivalent amount in euros). Additionally, we may, once a year, request renewal of the agreement for an additional one-year period. Also in 2021, we entered into a new 364-day unsecured revolving credit agreement (364-Day Credit Agreement), which expires on May 27, 2022… .. As of December 25, 2021, there were no outstanding borrowings under the Five-Year Credit Agreement or the 364-Day Credit Agreement.”[15]

Collectively PepsiCo have two committed lines of credit totaling $7.6 Billion available on demand provided they are within the loan covenants governing those contracts with their banks. The Coca-Cola Company has no committed credit facilities available for their general corporate borrowing purposes; it has several affiliates that do. Those affiliates that have the borrowing arrangements operate in varied jurisdictions and utilize non-USD currencies.[16] In addition, Coca-Cola notes that requirements exist for cash to be deposited with particular lenders under those arrangements.

Both Coca-Cola and PepsiCo disclosed their SFPs in their 2021 annual reports.[17] Coca-Cola’s disclosure included the following,

> “Amounts settled through the SCF program were $3,237 million and $2,810 million during the years ended December 31, 2021 and 2020, respectively. We do not believe there is a risk that our payment terms will be shortened in the near future.”[18]

PepsiCo’s disclosure stated,

> “We were informed by the participating financial institutions that as of December 25, 2021 and December 26, 2020, $1.5 billion and $1.2 billion, respectively, of our accounts payable

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[14] From: https://www.sec.gov/Archives/edgar/data/21344/000002134419000039/a201909208-kexhibit991.htm
[15] From: https://www.sec.gov/ix?doc=/Archives/edgar/data/77476/000007747621000007/pep-20201226.htm
[16] See Figures 8, 9, 10 and 11 in Appendix.
[17] The new FASB requirements start in 2023.
[18] From: https://www.sec.gov/ix?doc=/Archives/edgar/data/21344/000002134422000009/ko-20211231.htm

to suppliers who participate in these financing arrangements are outstanding. These supply chain finance arrangements did not have a material impact on our liquidity or capital resources in the periods presented and we do not expect such arrangements to have a material impact on our liquidity or capital resources for the foreseeable future."[19]

These SFP disclosures are different. They use a different quantification method, with PepsiCo providing the amount that was outstanding at the end of a reporting period based upon the balances of their SFPs at the bank agents, and Coca-Cola providing an annualized amount disbursed during a reporting period. Previously, in 2020, when the SEC questioned Coca-Cola about its SFP, the company responded as follows,

"Beginning in 2014, in an effort to improve our working capital efficiency, the Company began to extend our payment terms with our suppliers. Those efforts continued through 2019 and are now substantially complete. The payment term extensions in 2019 had the largest annual impact on our net cash provided by operating activities since we began this initiative in 2014. In 2014, we also initiated a voluntary supply chain finance ("SCF") program which allows our suppliers, at their sole discretion, to leverage the benefit of our credit rating. The SCF program is available to suppliers of goods and/or services included in cost of goods sold as well as suppliers of goods and services included in selling, general and administrative expenses on our consolidated statements of income. The Company worked with two global financial institutions to develop a SCF program that enables our suppliers to sell their receivables from the Company to these financial institutions on a non-recourse basis at a rate that leverages our credit rating and thus might be more beneficial to them. The Company and our suppliers agree on commercial terms for the goods and services we procure including prices, quantities, and payment terms regardless of whether the supplier elects to participate in the SCF program. The suppliers sell goods or services, as applicable, to the Company and they issue the associated invoices to the Company based on the agreed contractual terms. Then, our suppliers, if they elected to participate in the SCF program, at their sole discretion, determine which invoices, if any, they want to include in the SCF program.

Based on information provided to us by the two participating financial institutions upon our request in response to your comment letter, approximately 21 percent of our outstanding accounts payable balance as of December 31, 2019 and March 27, 2020 was sold by suppliers to the financial institutions as a result of the SCF program. This represents less than 3 percent of the balance of our current liabilities as of each of these dates. The Company did not disclose the SCF program in our prior SEC filings as we concluded the SCF program had not materially affected our liquidity in the periods presented and was not reasonably likely to materially affect our liquidity in future periods." [20]

[19] From: https://www.sec.gov/ix?doc=/Archives/edgar/data/77476/000007747621000007/pep-20201226.htm
[20] From: https://www.sec.gov/Archives/edgar/data/0000021344/000002134420000027/filename1.htm

While a very long response, it does little to shed any additional light on Coca-Cola's SFPs. We are not aware of any similar inquiry from the SEC to PepsiCo. An additional difference in working capital is the sale of trade receivables by Coca-Cola. While there are no references to such activities at PepsiCo, Coca-Cola began selling their trade receivables in 2021 according to their 10-K,

> "The fourth quarter of 2020, the Company started a trade accounts receivable factoring program in certain countries . . . the Company collects customer payments related to the factored receivables and remits those payments to the financial institutions. The Company sold $6,266 million and $185 million of trade accounts receivables under this program during the years ended December 31, 2021 and 2020 . . . accounts for this program as a sale, and accordingly, the trade receivables sold are excluded from trade accounts receivable on our consolidated balance sheet."[21]

In summary, significant differences exist in the commercial arrangements of each company's SFPs and their pre-FASB rule disclosures. The observable impacts of Coca-Cola's and PepsiCo's SFPs are such that they give the impression of significant performance differences between the two companies. Coca-Cola appears to have more aggressively managed its suppliers and customers, but this assessment cannot be further evaluated as it is doing business with affiliated companies. Limited information about these commercial engagements hampers investor ability to thoroughly assess the potential impact of these arrangements on the ability of each the company to fulfill its liabilities.

In particular, reported as trade payables, the analysis of these SFPs is hampered by the lack of specificity of the arrangements required to determine whether classification as payables is appropriate for either company. Limited information on access to bank funding—let alone overlaps and correlations among bank groups providing funding—create further challenges to the interpretation of financial condition, as neither company is clear about their access to credit.[22] To complete a holistic and accurate analysis of both companies, we believe investors should examine their reported numbers, together with a detailed and more precise description of their SFPs and their committed credit facilities. Fundamentally, as it stands, the disclosures of Coca-Cola and Pepsi are inconsistent, in turn limiting the effective value of audit certification and of ratings judgements based on this information. The new FASB disclosure requirements are broad, non-prescriptive, and will not provide investors with any more information than what has already been disclosed by Coca-Cola and PepsiCo unless companies choose to voluntarily disclose more than they did in their prior (pre-FASB required disclosures) or in their required FASB disclosures for their SFPs. For the avoidance of doubt this means investors will continue to struggle to compare the two companies in the context of their SFP usage and impacts on respective financial condition.

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[21] From: https://www.sec.gov/ix?doc=/Archives/edgar/data/21344/000002134422000009/ko-20211231.htm

[22] In the case of PepsiCo, we learn their $1.5 Billions SFP outstanding balance is over 19% of their committed credit facilities, which provides some information with respect to this question, however no analysis is possible for Coca-Cola given the information they disclosed.

4. Limited Credit Access Disclosures & the Risk of Contagion

In broad principle, FASB's requirements distinguish financial liabilities from other liabilities in the presentation of credit as debt, as well as in expenses and cash flows, and include required disclosure on certain types of credit, specifically that of committed lines of credit provided by a bank to a debtor. Beyond these requirements, however, limited additional information is available to users of financial statements about credit use, and no information is required to help users distinguish credit accessed outside of committed facilities (except on a specific reporting date). The uses of credit and related services *during* a reporting period are critical to understanding the operations and status of reporting entities as going concerns and, therefore, information on this is important for users of financial statements to evaluate the financial condition of a reporting entity. The uses of and access to credit, including any limitations and restrictions, as well as information about the diversity of possible funding sources, are all critical information for such an assessment. As discussed below, SFP utilization of the debtor's credit availability further constrains financial condition. None of this information is required to be provided in FASB disclosures.

Banks are mandated to hold capital for both drawn credit that is extended and for commitments to extend credit, both under a drawn credit facility or under a committed facility. Banks, however, have no requirement to hold capital for credit lines that are undrawn and not committed, known as "uncommitted" credit facilities. Such uncommitted credit facilities may, in fact, not even be the result of a typical debt agreement specifically, but rather in the form related to another contracted service like a demand deposit account, where an overdraft of that deposit account results in the bank providing credit to cover that overdraft which the bank is not obligated to do. Financial statements do not distinguish between uncommitted or committed credit use at reporting. An overdraft would be reported as debt on the day of the overdraft with the cash balance at that bank account as zero and the debt account the amount of the overdraft, but it would not be described as uncommitted or committed.

The distinction between a committed and uncommitted credit facility is extremely important, not least because access to credit facilities that are contractually committed enables borrowing to manage finance gaps. Given the absence of a capital charge for a bank for uncommitted credit facilities, the cost of such a facility—unless and until that facility is utilized—would likely not be charged to a debtor by the bank precisely because there is no requirement for it to be provided on demand. In a legal sense, unless there is consideration for the provision of that facility, it can be withdrawn at the discretion of the bank as there is no commitment (the basis for contract consideration) to maintain and provide credit. Further, the potential size or even the availability of uncommitted credit may not be disclosed to the borrower until or if it is even used. As already mentioned, under current FASB regulation it would not be disclosed unless it happens to be used specifically at the reporting period end date. Knowing if during the reporting period uncommitted credit facilities had been used by the filer is important for users of financial statements, as it reflects information regarding an entity's access to borrowing resources when needed. Economic and Federal Reserve research demonstrates significant use of uncommitted facilities and their

corresponding potential negative impact on a bank's access to funding and liquidity in the event of large market shocks, which limit access to borrowing for all debtors. Bank funding is always a conditional risk for all borrowers, including corporations, and therefore the nature and use of uncommitted credit facilities warrants significant attention.

The relationships between corporations and banks, with banks as suppliers, also share complex and multidimensional supplier characteristics, with two important elements: banks are regulatory-authorized depositors of all cash, including a corporation's cash, and are also providers of credit through both uncommitted and committed credit facilities in the event of funding gaps for corporations. An additional consideration for investors is that a bank's rights as a creditor may exceed those of other non-bank creditors, including bond holders, employees, customers, and suppliers in that they may have conditional security interests granting superior creditor protections in the event of a debtor deterioration or default.

In the context of the limited disclosures in the new FASB standards on the scope and use of borrowing, actual and prospective, it is important to note that SFPs utilize the credit capacity of the debtor and are uncommitted. It is also important to recognize that the nature of the debtor-bank relationship in a SFP is undisclosed and overlaps with other committed bank lenders, as opposed to being funded in the broader capital markets. These are critical considerations for investors evaluating financial condition, as neither debtor nor bank funding is assured. Under normal circumstances the risks associated with these SFP arrangements are limited, particularly for high quality companies. However, in environments of stress, financing risk usually emerges from two distinct sectors—from banks and from the capital markets. In a period of bank or market stress, the risks to a corporation may rise regardless of any unique stress that company may be experiencing individually. So, while an individual company's financing stress is situational to that company, an individual corporate and bank and capital markets stress may be correlated to each other in situations of contagion.

According to recent Federal Reserve research on revolving credit and bank funding risk,

> "As of January 10, 2021, the twenty largest U.S. bank holding companies had around $2 trillion of credit line commitments, of which approximately $1.5 trillion were committed but remained undrawn. Credit lines give companies the option to borrow funds at a pre-agreed fixed spread over a floating reference rate. When borrowers draw on their lines, banks need to source the required cash—sometimes by borrowing in wholesale funding markets. Because credit line drawdowns tend to be larger when funding markets are stressed, the provision of revolving credit is associated with a funding risk." [23]

The Federal Reserve noted an increase in bank funding costs and corporate drawings on bank credit during banking and capital market stress periods such as the Global Financial Crisis & COVID.[24]

[23] From: https://www.newyorkfed.org/research/staff_reports/sr1042
[24] See Figures 12 and 13 in Appendix.

Unanticipated credit extensions require banks to rebalance their assets and the research demonstrates such unanticipated events are correlated to funding costs. Banks have limited ability to quickly rebalance assets as only a percentage of their assets can quickly be liquidated to fund other assets such as a loan drawing. When credit is drawn under commercial and industrial borrowing at too rapid a rate, or at too large a scale, a bank's ability to provide credit becomes strained. This is one element of Federal Reserve's "stress testing" to analyze bank operations and ability to continue lending under scenarios that strain both individual banks and the banking system. Historical interventions in the past two decades have seen the Federal Reserve increase the size of the banking system to alleviate stress. Many observers believe such actions have led to inflation as a result.

5. Assessing Financial Condition

The day-to-day generation of cash for a corporation is a function of the nature of its sales contracts and operations while the use of that cash is a function of its purchases, contracts, payroll, and operations. To fund gaps, companies rely on borrowing, sales of assets or raising equity, but they also can generate cash by slowing, reducing or eliminating disbursements—like for accounts payable—or reducing the dividend or pausing stock buybacks. Borrowing to raise cash typically happens in two ways, in the capital markets or from banks, and is dependent on the perception of credit worthiness of the borrower. For example, with investment grade debtors, money can be quickly borrowed in the capital markets either in short term form—typically by issuing commercial paper—or for medium- or longer-term needs by issuing bonds. Those investment grade borrowers can also utilize bank lending as well, and as discussed, that lending is available in two forms—committed and uncommitted. In the case of high yield debtors, money typically can only be borrowed through medium term bonds or loans, and they can also utilize bank lending. However, for all borrowers, access or availability of capital markets borrowing is not assured and is contingent on market conditions, including the cost of funds. As already noted earlier, the lack of disclosure on SFP outstanding amounts, limits the ability to assess the financial condition of companies, and this problem is further compounded by any overlap among the banks providing the SFPs and the possible correlation to financing conditions overall, which limit gross access to credit and credit availability from a group of lenders.

Raising cash rapidly can come in two forms, via either borrowing or from selling an asset. The ability to borrow money when needed is often referred to as "access to liquidity" and can be procured from lenders or via capital market borrowing. The ability to sell an asset quickly, like an investment, is also referred to as "access to liquidity". Banking regulators, led by the Bank for International Settlements and including The Federal Reserve, define assets that are "High Quality, Liquid Assets" if they can typically be sold quickly and at a minimal transaction cost.[25] No universal measures exist, however, to define those characteristics either in terms of access to borrowing money or in terms of ability to convert assets into money, nor are there any definitions of the external conditions—such as bank solvency or capital market availability—that need exist to enable either. Unlike in physics,

[25] See: https://www.bis.org/press/p130106a.pdf

which defines "liquid" as a state of matter that can change to another state under certain conditions, no such transition distinctions exist for characterizing states of liquidity as applied to access to borrowing or to the ability to sell an asset.

Given this, evaluation of financial condition, including access to liquidity and the ability to generate cash from assets, is difficult to assess under current disclosure guidelines, while bank-related stress is not possible to assess for any individual corporation. FASB SFP disclosures compound these issues by not requiring the necessary information to evaluate whether the SFP is debt or accounts payable nor other pertinent information about the SFPs. To address these investor needs, users require the following voluntary additional disclosures from filers:[26]

1. To determine whether an SFP is payables or debt, an investor needs to know whether the debtor has granted any rights to the bank beyond the payment date and amount of payment, including (i) rights to collateral; (ii) establishing pricing between the bank with the suppliers; (iii) the syndication of the SFP credit facility to other banks; (iv) directing or restricting any activities of the bank in terms of an independent role in discounting receivables and; (v) a description of any fees that may be paid to the debtor from the SFP providers, including whether fees are paid in cash or earned under compensating balance agreements or through other services arrangements with the bank. If one considers the totality of the arrangement, as advised by the SEC, any one of these characteristics would classify an SFP as debt instead of payables.
2. To evaluate financial condition impacts of SFPs, an investor needs to know whether the specific banks that provide the SFP and other financing services to that debtor, are the same banks that are the debtor's asset depositories, and/or whether any of those banks are providers of revolving credit facilities or other uncommitted credit, and if so how much credit was utilized under the arrangement as well as a concurrent utilization and gross amounts of committed credit.

6. Conclusion

SFPs are a beneficial, albeit complicated credit offering involving three interrelated contracts for financing. As described above, these agreements are interdependent raising issues from an accounting perspective as to whether the appropriate liability classification of an SFP should be as payables or debt. Debt is defined as an arrangement that provides a lender with a contractual right to receive consideration and a borrower with a contractual obligation to pay consideration on demand or on fixed or determinable dates. On the surface SFPs meet this definition and in fact in many cases SFPs should indeed be classified as debt. The nature of consideration by the buyer to the bank seems likely as the key determining characteristic for this assessment. FASB regulation, however, fails to require this disclosure.

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[26] See the following for more information:
https://www.fasb.org/document/blob?fileName=SPLYCHN.ED.011.FERMAT_CAPITAL_MANAGEMENT_LLC_ADAM_L._DENER.pdf

Banks are critically important vendors to corporations and have superior positions as creditors relative to other vendors. It is important for investors to assess a debtor's use of SFPs and the impact of that use on cash and the prospective impact on access to borrowing. It is also important to consider the SFP impacts on prospective withdrawal of credit or on the utilization of uncommitted credit facilities, like those supporting SFP arrangements. In addition, investors should consider other leveraging or accelerating techniques involving uncommitted bank lending that can cease or be withdrawn. FASB disclosures are of limited benefit to investors on any of these points above, unless financial statement filers provide supplemental information not currently required by the rules. In summary:

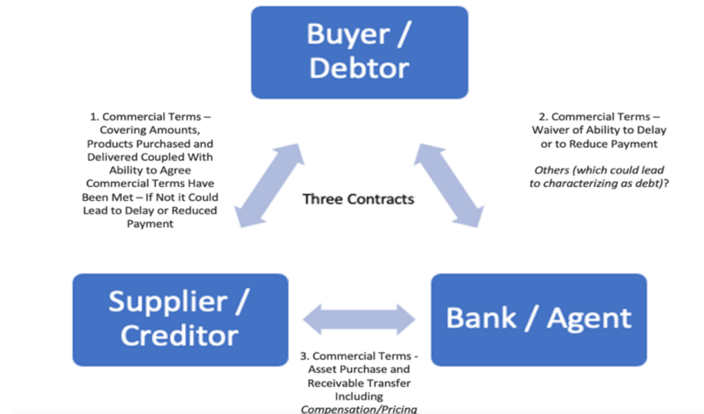
1. SFPs may alter financial condition and may increase the debt of a company.
2. SFPs reduce access to bank funding as they utilize financing of the company's bank group providing the committed credit.
3. Critical gaps remain in FASB rules, as corporations are not required to provide details on their access to bank credit. This is further exacerbated by the limited frequency and substance of interim financial statement reporting.

To date, SFP disclosure requirements are limited to the following: i) the gross amount of the confirmed SFP liability, ii) identifying where the liability is recorded on the balance sheet, as well as iii) periodic "roll forwards" of confirmed amounts and, iv) an unstructured description of the program. This is not sufficient for investors to address the key issues outlined above. As demonstrated with the Coca-Cola versus PepsiCo example, analytical insights are limited to the use of, relative size of and scope of use among companies unless supplemental information is voluntarily provided. The scope and frequency of management information potentially available for analysis dwarfs what is made available to investors. Further, audits happen annually using lagging statements and ratings agencies reviews, when provided, also happen infrequently. Auditors and ratings firms are paid by the companies they assess and for other critical services including SFP, banks—as lenders, as broker dealers and as research providers—are all company vendors paid by company management. Investors should be cognizant of the potential for incentive misalignment among the varied vendors that provide debtor services. Investors are not vendors and are reliant on the services of these parties, as well as on information shared by corporate management whose principal quantitative incentive, set by Boards, is to optimize equity returns.

Accounting reporting is a "one size fits all" exercise despite the unique and individual needs of a wide range of stakeholders that rely on it: retail, institutional, equity and fixed income investors, as well as suppliers, creditors, and employees. Throughout and among those varied parties there is significant reliance on management and management judgement, as well as on the vendors providing services to management given the limited regulatory, supervisory and governance frameworks in place. Investors would be wise to review SFPs, credit access, use of committed and uncommitted credit and banking arrangements when assessing companies, and regulators and standards setting bodies would be wise to assist investors in doing so.

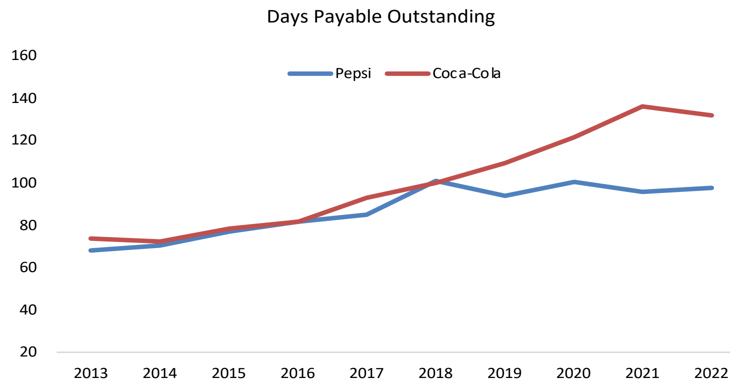
7. Appendix

Figure 1: Schematic of a Supplier Finance Program



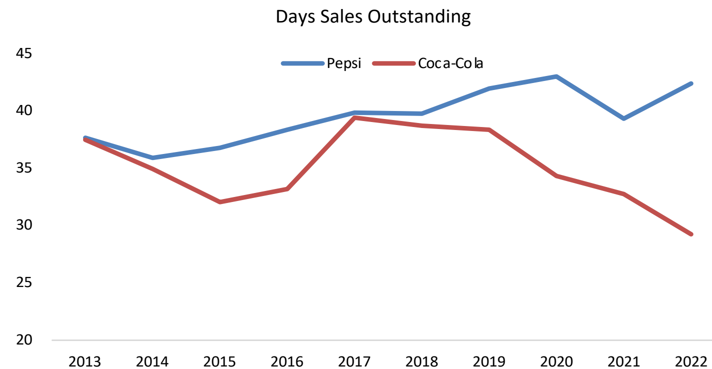
Source: Authors

Figure 2: Days Payable Outstanding



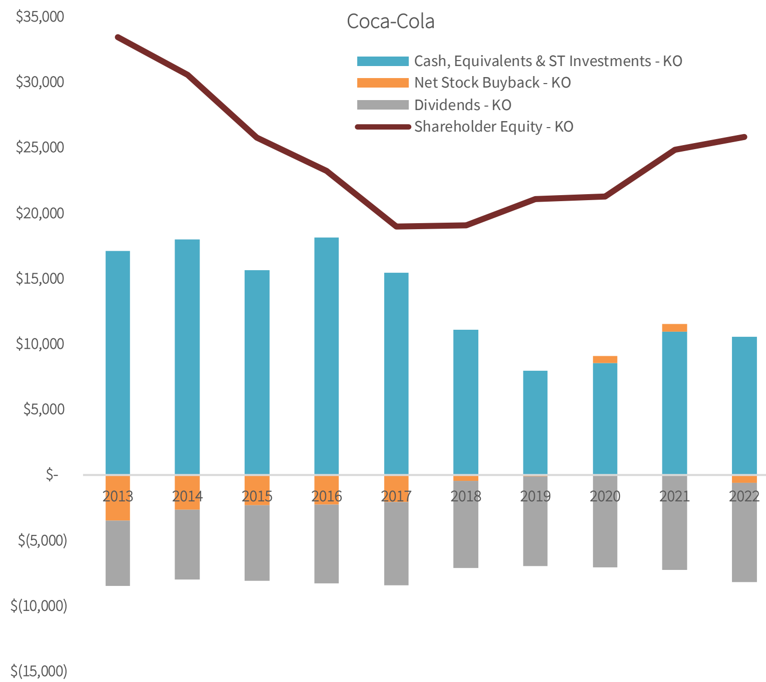
Source: Data from Bloomberg, analysis by Authors

Figure 3: Days Sales Outstanding



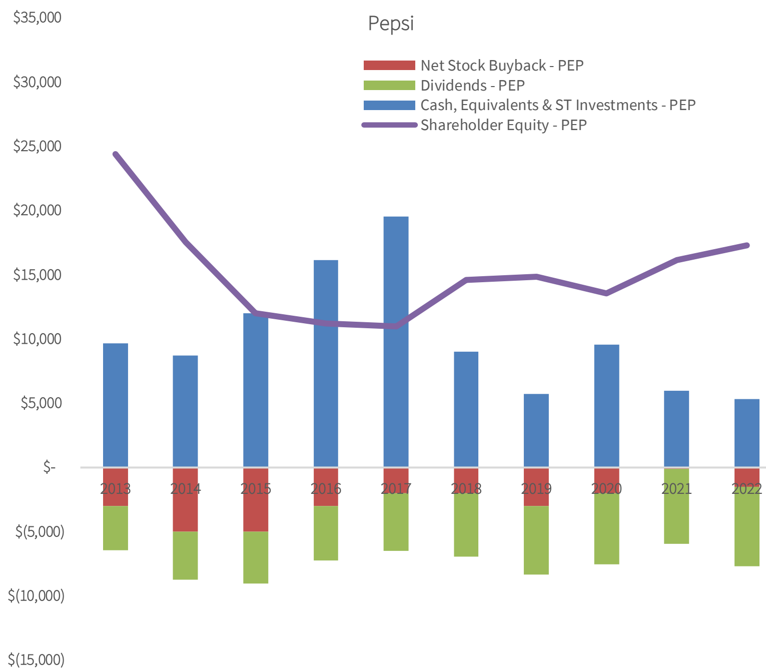
Source: Data from Bloomberg, analysis by Authors

Figure 4: Cash & Dividend and Stock Repurchases for Coca-Cola



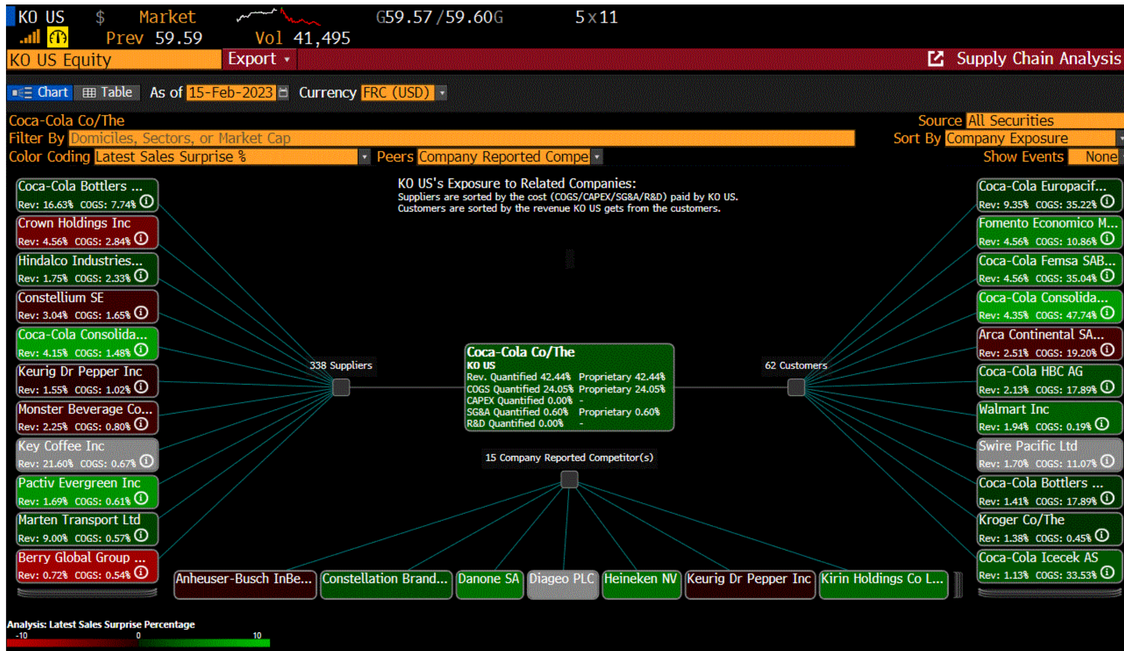
Source: Data from Bloomberg, analysis by Authors

Figure 5: Cash & Dividend and Stock Repurchases for PepsiCo



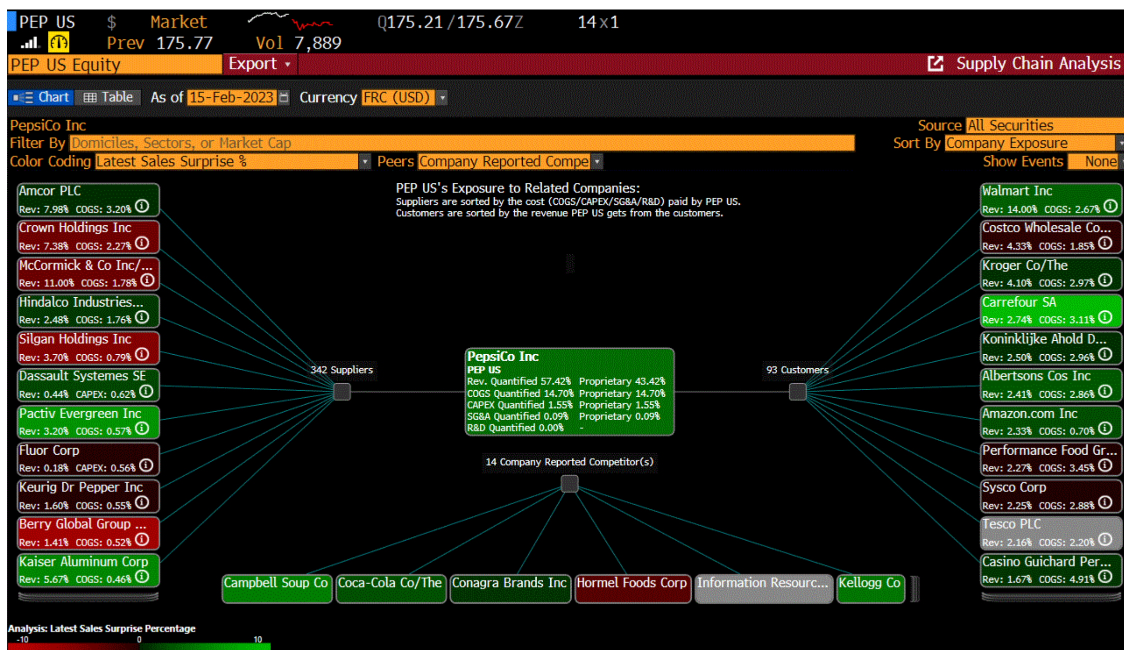
Source: Data from Bloomberg, analysis by Authors

Figure 6: Major Supply and Customer Relationships, The Coca-Cola Company



Source: Bloomberg SPLC function, accessed on February 15, 2023

Figure 7: Major Supply and Customer Relationships, PepsiCo



Source: Bloomberg SPLC function, accessed on February 15, 2023

Figure 8: Loan Facilities of Coca-Cola

<Search> 98) Export 12 results Security Finder

Category Fixed Income

Corp Govt Loan Pfd CDS CDS Idx Muni Futr Opt IRS IRS Vol Gen Govt Muni Issuer

60) Exclusions: (6) Deal level 62) Advanced Search | SRCH » 61) Column Settings

R	Borrower	Ticker	Maturity	Type	Curr	Rank	Status
		KO					
1)	Coca-Cola Co/The	KO	04/05/2021	Term	USD	Unsecured	Retired
2)	Coca-Cola Co/The	KO	08/03/2012	Revolver	USD	Guarantee, Unsecured	Matured
3)	Coca-Cola Sabco East Africa Ltd	KO	04/22/2025	Revolver	USD	Senior, Unsecured	Signed
4)	Coca-Cola Beverages South Africa ...	KO	04/22/2025	Term	ZAR	Senior, Unsecured	Signed
5)	Coca-Cola Sabco East Africa Ltd	KO	10/22/2023	Revolver	USD	Senior, Unsecured	Signed
6)	Century Bottling Co Ltd	KO	06/17/2025	Revolver	UGX	Senior, Unsecured	Signed
7)	Century Bottling Co Ltd	KO	06/17/2025	Term	UGX	Senior, Unsecured	Signed
8)	Coca-Cola Beverages South Africa ...	KO	04/22/2025	Revolver	ZAR	Senior, Unsecured	Signed
9)	Coca-Cola Sabco East Africa Ltd	KO	04/22/2025	Revolver	USD	Senior, Unsecured	Signed
10)	Coca-Cola Beverages South Africa ...	KO	09/11/2024	Term	ZAR	Senior, Unsecured	Refinanced
11)	Coca-Cola Beverages South Africa ...	KO	09/11/2024	Revolver	ZAR	Senior, Unsecured	Refinanced
12)	Coca-Cola Sabco East Africa Ltd	KO	10/22/2023	Revolver	USD	Senior, Unsecured	Signed

Source: Bloomberg, accessed February 15, 2023

Figure 9: Loan Facilities of PepsiCo

<Search> 98) Export 1-20 of 66 results Security Finder

Category Fixed Income

Corp Govt Loan Pfd CDS CDS Idx Muni Futr Opt IRS IRS Vol Gen Govt Muni Issuer

60) Exclusions: (53) Deal level 62) Advanced Search | SRCH » 61) Column Settings

R	Borrower	Ticker	Maturity	Type	Curr	Rank	Status
		PEP					
1)	PepsiCo Inc	PEP	05/27/2027	Revolver	USD	Unsecured	Signed
2)	PepsiCo Inc	PEP	05/26/2023	Revolver	USD	Unsecured	Signed
3)	PepsiCo Inc	PEP	06/10/2018	Revolver	USD	Unsecured	Refinanced
4)	PepsiCo Inc	PEP	06/09/2014	Revolver	USD	Unsecured	Matured
5)	PepsiCo Inc	PEP	06/08/2015	Revolver	USD	Unsecured	Refinanced
6)	PepsiCo Inc	PEP	06/09/2019	Revolver	USD	Unsecured	Refinanced
7)	PepsiCo Inc	PEP	06/08/2020	Revolver	USD	Guarantee, Unsecured	Refinanced
8)	PepsiCo Inc	PEP	06/06/2016	Revolver	USD	Unsecured	Refinanced
9)	PepsiCo Inc	PEP	06/06/2021	Revolver	USD	Guarantee, Unsecured	Refinanced
10)	PepsiCo Inc	PEP	06/05/2017	Revolver	USD	Unsecured	Matured
11)	PepsiCo Inc	PEP	06/05/2022	Revolver	USD	Unsecured	Refinanced
12)	PepsiCo Inc	PEP	06/04/2018	Revolver	USD	Unsecured	Matured
13)	PepsiCo Inc	PEP	06/03/2019	Revolver	USD	Unsecured	Matured
14)	PepsiCo Inc	PEP	06/04/2023	Revolver	USD	Unsecured	Refinanced
15)	PepsiCo Inc	PEP	06/03/2024	Revolver	USD	Unsecured	Refinanced
16)	PepsiCo Inc	PEP	06/02/2020	Revolver	USD	Unsecured	Refinanced
17)	PepsiCo Inc	PEP	05/31/2021	Revolver	USD	Unsecured	Matured

Source: Bloomberg, accessed February 15, 2023

Figure 10: A Committed Credit Facility, PepsiCo

PEP REV UNSEC USD $Data Unavailable See ALLQ <GO> for Sources

PEP REV UNSEC USD Corp | Actions | Settings | Contact IR | Page 1/13 Security Description: Loan

No Notes | 95) Buy | 96) Sell

25) Tranche | 26) Deal | 27) Issuer Description

Pages: 11) General Info, 12) Additional Info, 13) Involved Parties, 14) Covenants, 15) Ratings, 16) Amortization, 17) Amendments, 18) Pricing & Fees, 19) Electronic Filing, 20) Contracts, 21) Permissioning, 22) Change History, 23) Coupons

Quick Links: 32) CN News, 33) QMGR Quotes, 34) COMB Compare, 35) MA M&A, 36) HDS Holdings, 60) Send Tranche

Tranche Description

Name	PepsiCo
Borrower	PepsiCo Inc
Industry	Food and Beverage (BCLASS)
Purpose	Refinance, General Corporate Purposes
Status	Signed
Type	Revolver
Rank	Unsecd
Agent	Citibank NA
Sponsors	
Idx + Margin	TSFR1M + 10 bps + 62.5 bps
Index Floor	0 bps
Issue Price	--
Size	USD 3,800,000,000 on 05/27/2022
Outstanding	USD 0 on 09/03/2022
Total Util	--

Identifiers

ID Number	BL3933746
FIGI	BBG0185Z5F63
CUSIP	713453CF3

Summary Criteria

Leveraged	No
Covenant Lite	No
Borrowing Base	No
LOC	No

Ratings	Tranc...	Issuer
Moody's		A1
S&P		A+
Fitch		WD

Dates

Announced	05/27/2022
Signed	05/27/2022
Effective	05/27/2022
Maturity	05/27/2027

Source: Bloomberg, accessed February 15, 2023

Figure 11: Committed Credit Facility, PepsiCo

PEP REV UNSEC USD $Data Unavailable See ALLQ <GO> for Sources

PEP REV UNSEC USD Corp | Actions | Settings | Contact IR | Page 1/13 Security Description: Loan

No Notes | 95) Buy | 96) Sell

25) Tranche | 26) Deal | 27) Issuer Description

Pages: 11) General Info, 12) Additional Info, 13) Involved Parties, 14) Covenants, 15) Ratings, 16) Amortization, 17) Amendments, 18) Pricing & Fees, 19) Electronic Filing, 20) Contracts, 21) Permissioning, 22) Change History, 23) Coupons

Quick Links: 32) CN News, 33) QMGR Quotes, 34) COMB Compare, 35) MA M&A, 36) HDS Holdings, 60) Send Tranche

Tranche Description

Name	PepsiCo
Borrower	PepsiCo Inc
Industry	Food and Beverage (BCLASS)
Purpose	Refinance, General Corporate Purposes
Status	Signed
Type	Revolver
Rank	Unsecd
Agent	Citibank NA
Sponsors	
Idx + Margin	TSFR1M + 10 bps + 62.5 bps
Index Floor	0 bps
Issue Price	--
Size	USD 3,800,000,000 on 05/27/2022
Outstanding	USD 0 on 09/03/2022
Total Util	--

Identifiers

ID Number	BL3966639
FIGI	BBG018LWK344
CUSIP	713453CD8

Summary Criteria

Leveraged	No
Covenant Lite	No
Borrowing Base	No
LOC	No

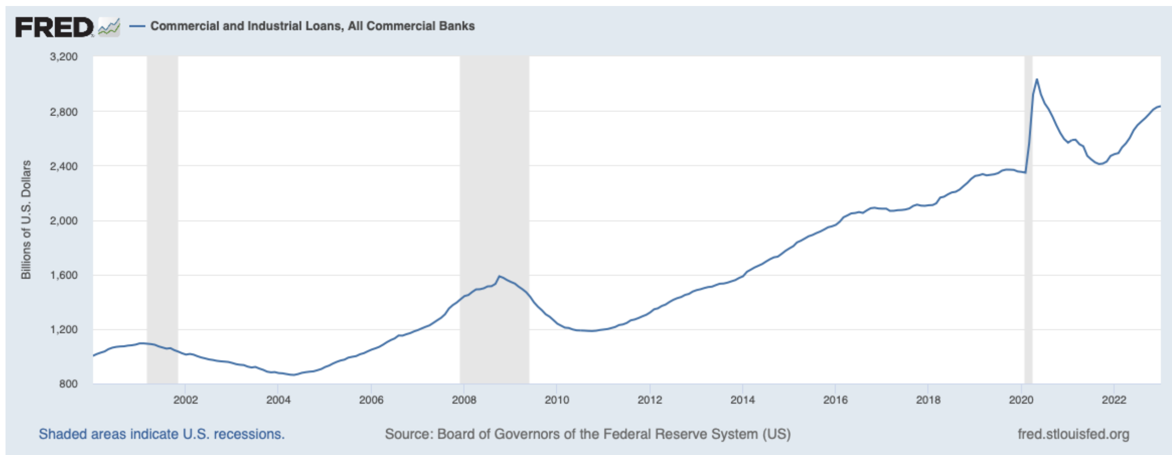
Ratings	Tranc...	Issuer
Moody's		A1
S&P		A+
Fitch		WD

Dates

Announced	05/27/2022
Signed	05/27/2022
Effective	05/27/2022
Maturity	05/26/2023

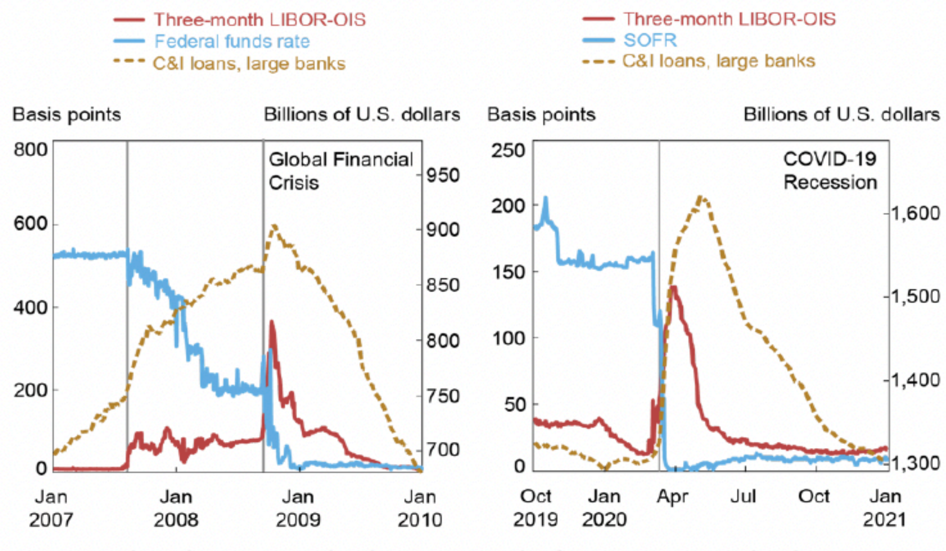
Source: Bloomberg, accessed February 15, 2023

Figure 12: Commercial and Industrial Loans



Source: Federal Reserve

Figure 13: Rates and Commercial and Industrial Loans



The panels plot bank funding rates and large bank commercial and industrial lending during the global financial crisis and the COVID-19 shock. Vertical lines mark important dates for the crises (left to right: BNP Paribas freezes funds citing problems with subprime mortgages, Lehman Brothers files for bankruptcy; World Health Organization declares COVID-19 a pandemic).

Source: Federal Reserve