Contents

Application of ASU 2016-15 to the Sale of Trade Receivables to Multi-Seller Commercial Paper Conduit Structures

The following update to this *Financial Reporting Alert* reflects recent guidance provided by the SEC's Office of the Chief Accountant:

In recent discussions with the SEC's Office of the Chief Accountant, we were informed that the SEC staff believes that it is only appropriate to apply View A (discussed below). For entities that have previously filed financial statements with the SEC and have applied View B, we understand that (1) the SEC staff will not object to a change to View A in the next periodic filing as a change in presentation and (2) such change does not require a preferability letter. In a manner consistent with the transition requirements of ASU 2016-15 (discussed below), the change should be reflected retrospectively to all prior financial reporting periods for which View B was applied.

With respect to the reporting period ended June 30, 2018, some entities will be unable to make the change in presentation either because the Form 10-K or 10-Q has already been filed or because the entity does not have the information necessary to make the change. In that case, we understand that the SEC staff will not object if the entity files financial statements under View B with appropriate disclosure, which might include the following (subject to materiality considerations):

- The nature of the issue and related transactions.
- A statement that the entity intends to change the method of presentation in its next periodic filing and that the change will be reflected on a retrospective basis to all periods presented.
- The anticipated effect (increase/decrease) on operating cash flows and investing cash flows.
- The anticipated magnitude of the change if reasonably estimable (e.g., whether the change is expected to be material) or a statement that no such estimate can be made.

Entities with questions, including those that believe that application of View A is impracticable in the next periodic filing or with respect to retrospective application to prior periods, should consult with their independent advisers.

Overview

In August 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. The ASU's guidance is effective as follows:

- For public business entities, it is effective for financial statements issued for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years.
- For all other entities, it is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019.

Thus, the guidance is effective for calendar-year-end public business entities whose first quarter ended March 31, 2018. It must be applied retrospectively to all periods presented unless it is impracticable to do so; entities may then apply it prospectively as of the earliest date practicable.

Questions have arisen regarding how to apply the ASU's guidance on beneficial interests in securitization transactions, particularly for entities that have sold trade receivables to a multi-seller commercial paper conduit structure. This *Financial Reporting Alert* addresses those implementation issues.

The ASU amended ASC 230-10-45-12(a) and ASC 230-10-50-4[1] to require (1) disclosure of a transferor's beneficial interest obtained in a securitization of financial assets as a noncash activity and (2) classification of cash receipts from payments on a transferor's beneficial interests in securitized trade receivables as cash inflows from investing activities. As amended, ASC 230-10-45-12(a) states that cash inflows from investing activities include the following (added text is <u>underscored</u>):

> a. Receipts from collections or sales of loans made by the entity and of other entities' debt instruments (other than cash equivalents, certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21, and certain donated debt instruments received by not-for-profit entities (NFPs) as discussed in paragraph 230-10-45-21A) <u>and collections on a transferor's beneficial interests in a securitization of the transferor's trade receivables</u>.

As amended, ASC 230-10-50-4 states the following (added text is <u>underscored</u>):

> Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; obtaining an asset by entering into a capital lease; <u>obtaining a beneficial interest as consideration for transferring financial assets (excluding cash), including the transferor's trade receivables, in a securitization transaction</u>; obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

An entity that has sold trade receivables to a multi-seller commercial paper conduit structure must apply this guidance as well as the requirements in ASC 230-10-45-16(a).[2]

[1] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[2] ASC 230-10-45-16(a) states that cash inflows from operating activities include "[c]ash receipts from sales of goods or services, including receipts from collection or sale of accounts and both short- and long-term notes receivable from customers arising from those sales. The term goods includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21." In accordance with this guidance, an entity presents the proceeds received upon a sale of trade receivables as an operating activity. As discussed below, the proceeds received on the sale of trade receivables to a securitization entity is represented by CPP.

While commercial paper conduit structures may differ, common features of such programs include the following:

- An entity (the "seller") transfers trade receivables to a nonconsolidated securitization entity. Such transfers qualify as sales under ASC 860.
- The seller transfers trade receivables at the inception of its involvement with the securitization entity and continues to transfer trade receivables to the securitization entity as frequently as daily. The securitization entity also receives collections from the seller's trade receivables previously sold as frequently as daily.
- The seller continues to service the trade receivables sold to the securitization entity.
- For each trade receivable transferred to the securitization entity, the seller has the right to receive cash at a maximum advance rate. The maximum advance rate, which is determined by a formula in the agreements related to the securitization, represents the maximum amount of cash the seller can receive upon the transfer of trade receivables to the securitization entity. If the amount of cash available from the securitization entity to purchase trade receivables from the seller on a particular day is less than the maximum advance rate, the seller is entitled to only the available cash upon transfers of trade receivables to the securitization entity.
- The amount of cash received by the seller upon each sale of trade receivables to the securitization entity is referred to as the cash purchase price (CPP), and the remaining consideration received for the transfer of trade receivables is represented by a deferred purchase price (DPP). The DPP represents a beneficial interest in the securitization entity.
- After the initial transfer of trade receivables at the inception of the seller's involvement with the securitization entity, the cash available to pay the CPP related to transfers of trade receivables is generally limited to the amount of cash received from collections of trade receivables previously sold to the securitization entity. To the extent that there are insufficient "same day" collections to fund the maximum advance rate, the entity will legally receive an additional DPP interest.
- Any cash collections on previously transferred trade receivables that exceed the maximum advance rate for that same day's trade receivables sold to the securitization entity are held in an escrow account until each periodic settlement date.
- The settlement period is monthly. At the end of each monthly settlement period, the amounts in the escrow account are disbursed to (or retained by) the seller, the administrative agent of the conduit and other service providers, and the conduit in accordance with the terms of the securitization entity. The amount of cash in the escrow account to which the seller is entitled represents repayments of DPP amounts and, to some extent, a deferred payment of CPP amounts related to days on which the cash available as CPP for transfers of trade receivables was less than the maximum advance rate because the collections on trade receivables previously sold on that particular day were insufficient to pay the maximum advance rate.

The guidance in ASU 2016-15 is not clear regarding the unit of account for determining the portions of each transfer of trade receivables to a securitization entity that represent CPP (i.e., operating activities) and DPP (i.e., investing activities). Therefore, we understand that the following two primary views have emerged:

- *View A: The unit of account is each day's transactional activity* — An entity evaluates each day's transactional activity to determine the CPP and DPP portions of trade receivables transferred to the securitization entity. Thus, if the cash available from a particular day's collections of previously sold trade receivables is not sufficient to fund the maximum advance rate on that day's trade receivables sold to the securitization entity, that deficit will reflect a noncash investing activity, which, when collected, will represent an investing activity.
- *View B: The unit of account is each month's transactional activity* — To determine the CPP and DPP portions of trade receivables sold during a monthly period, an entity considers the cumulative activity that has occurred during the month. The entity's assessment under this view is aligned with the frequency of disbursements associated with the monthly settlements from the escrow account applicable to the seller's transactional activity with the securitization entity. Thus, if the cash available from a particular day's collections of previously sold trade receivables is not sufficient to fund the maximum advance rate on that day's trade receivables sold to the securitization entity, that deficit will still be reported as an operating activity if there is a sufficient excess of subsequent collections on previously sold trade receivables over the maximum advance rate for those trade receivables subsequently sold to the securitization entity. However, in no situation would the operating cash flows (CPP) portion during a monthly settlement period exceed the maximum advance rate applicable to trade receivables sold during that monthly period.

Pending clarification of the ASU's guidance from the FASB or SEC, we believe that either view is acceptable.[3] If the guidance is clarified, we will update this *Financial Reporting Alert* and provide transition considerations. The appendix below illustrates the application of the two views.

[3] The acceptability of View B is premised on a settlement period that is no less frequent than monthly. Typically, these types of securitization entities have monthly settlement periods. There may also be acceptable views other than those addressed in this *Financial Reporting Alert*.

Appendix — Illustration of the Applications of Views A and B

Assume that on February 1, 2018, Company X enters into a revolving commercial paper securitization arrangement involving trade receivables. At inception, X transfers $50,000,000 of trade receivables and receives CPP of $40,000,000 and DPP of $10,000,000. The maximum advance rate for each subsequent transfer of trade receivables is 80 percent.[4] Company X is the servicer of the trade receivables sold to the securitization entity. On a monthly settlement basis, which is the last day of each month (the payment date), payments are made from the escrow account to X and the securitization entity. The securitization entity has reached its funding limit; therefore, the only source of cash to pay for newly transferred trade receivables sold each day by X are collections on trade receivables previously sold to the securitization entity by X. Collections received on a daily basis can be used by X to pay for trade receivables transferred on that same day up to the maximum advance rate. Excess cash collected must be retained in the escrow account until the monthly settlement. For simplicity, it is assumed in this example that the purchase price for each trade receivable sold is the face amount even though the purchase price may be discounted to permit the securitization entity to collect a fee and have sufficient cash to pay interest on its commercial paper obligations. The example also ignores amounts from daily collections that must be separately set aside in the escrow account for payment of interest and fees that are due to the securitization entity, and it assumes that there are no credit losses.

Further assume that the following transactional activity occurred during the monthly settlement period that ended February 28, 2018:

Day[5]	A/R Transfers	A/R Collections	CPP[6]	DPP	Total	Escrow Acct.[7]
2/1/2018	$ 50,000,000	$ —	$ 40,000,000	$ 10,000,000	$ 50,000,000	$ —
2/2/2018	4,000,000	1,000,000	1,000,000	3,000,000	4,000,000	—
2/5/2018	1,500,000	2,000,000	1,200,000	300,000	1,500,000	800,000
2/6/2018	800,000	2,000,000	640,000	160,000	800,000	1,360,000
2/7/2018	3,000,000	4,225,000	2,400,000	600,000	3,000,000	1,825,000
2/8/2018	1,750,000	725,000	725,000	1,025,000	1,750,000	—
2/9/2018	750,000	1,500,000	600,000	150,000	750,000	900,000
2/12/2018	3,500,000	1,200,000	1,200,000	2,300,000	3,500,000	—
2/13/2018	4,500,000	1,200,000	1,200,000	3,300,000	4,500,000	—
2/14/2018	1,000,000	500,000	500,000	500,000	1,000,000	—
2/15/2018	4,000,000	1,000,000	1,000,000	3,000,000	4,000,000	—
2/16/2018	975,000	5,000,000	780,000	195,000	975,000	4,220,000
2/19/2018	800,000	4,000,000	640,000	160,000	800,000	3,360,000
2/20/2018	5,000,000	3,175,000	3,175,000	1,825,000	5,000,000	—
2/21/2018	4,400,000	3,250,000	3,250,000	1,150,000	4,400,000	—
2/22/2018	3,200,000	5,000,000	2,560,000	640,000	3,200,000	2,440,000
2/23/2018	800,000	475,000	475,000	325,000	800,000	—
2/26/2018	3,175,000	4,000,000	2,540,000	635,000	3,175,000	1,460,000
2/27/2018	2,500,000	6,000,000	2,000,000	500,000	2,500,000	4,000,000
2/28/2018	4,350,000	3,750,000	3,480,000	870,000	4,350,000	270,000
	$ 100,000,000	$ 50,000,000	$ 69,365,000	$ 30,635,000	$ 100,000,000	$ 20,635,000

4 In practice, the formula underlying the maximum advance rate is often more complex than a single percentage amount.

5 Includes business days only.

6 CPP on any day equals the lessor of (1) cash collections on that day and (2) 80 percent of that day's transfers.

7 The escrow account is a balancing account until monthly settlement that represents the cash collected on previously transferred receivables less the amount of CPP for trade receivables sold during the period. In practice, this may also be referred to as a collections account.

The amount in the escrow account as of February 28, 2018, is paid to X and the securitization entity as follows (the amount paid to the securitization entity represents the amount of fees and interest on the commercial paper obligations):

Company X	$	20,385,000
Securitization entity		250,000
	$	20,635,000

The following is a rollforward of X's DPP balance:

2/1/2018	$	10,000,000
Additions		20,635,000
Escrow collections		(20,385,000)
Expenses		(250,000)
	$	10,000,000*

* This amount appropriately equals 20 percent of the trade receivable balances outstanding at the end of the month.

Company X's statement of cash flows for the one-month period ended February 28, 2018 (ignoring, for simplicity, the $250,000 expenses), would reflect the following:

	View A	View B
Operating activities	$ 69,365,000	$ 80,000,000
Investing activities	$ 20,635,000	$ 10,000,000
Noncash investing activities	$ 10,000,000	$ 10,000,000

Under View A, all the escrow amounts that X is entitled to upon the monthly settlement are considered repayments of DPP (i.e., investing activities). Under View B, the escrow amounts that X is entitled to upon the monthly settlement are first considered CPP payments (i.e., operating activities) up to the maximum advance rate applicable to that period's trade receivables sold to the securitization entity that was not paid on the same day the trade receivables were sold. The excess amount represents repayments of DPP (i.e., investing activities).

Note that in this example, it is assumed that the monthly settlement period aligns with the end of the financial reporting period. However, such periods frequently do not align. In those situations, an entity that applies View B must use judgment to determine how to appropriately take into account the differences between the end of the monthly settlement period and the end of the financial reporting period.