Accounting Standards Review: December 2022

This report gives investors the scoop on what's happening at the Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB), and how newly issued accounting standards updates (ASUs) affect fundamental research.

The ASU below will affect how companies report financial information, and we detail the impact on our financial models below. Get more details on other recent ASUs and their impact on our models here.

ASU 2022-04 – Liabilities-Supplier Finance programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations

This update aims to enhance the transparency of supplier finance programs (also referred to as reverse factoring). Prior to this update, there were no explicit disclosure requirements for supplier finance programs and obligations covered by these programs were bundled into other balance sheet line items.

The amendments in this update will require companies to disclose additional information about the use of supplier finance programs so financial statement users can understand the effect of these programs on a company's financial statements.

Supplier finance programs involve a buyer, a supplier, and a third-party finance provider. In a supplier finance program, a buyer will have an arrangement with the third-party finance provider, which can offer suppliers a discounted payment on behalf of the buyer before the invoice due date. In turn, the third-party provider will typically extend the invoice date and receive full payment from the buyer.

The amendments in this update require the buyer to disclose the following information about the supplier finance program:

1. The key terms of the program, including a description of the payment terms (including payment timing and basis for its determination) and assets pledged as security or other forms of guarantees provided for the committed payment to the finance provider or intermediary
2. For the obligation amount that the buyer has confirmed as valid to the finance provider or intermediary:
    a. Amount outstanding (amount that remains unpaid by the buyer) as of the end of the annual period
    b. Description of where that amount is presented in the balance sheet
    c. A roll-forward of those obligations during the annual period, including the amount of obligations confirmed and the amount of obligations subsequently paid.

The amendments in this update are effective for the fiscal years beginning after December 15, 2022. This amendment will not affect our models as we already treat these (albeit rarely disclosed) obligations as debt. However, we expect to see increased disclosure, and therefore transparency, of this type of obligation. Investors should be aware that this amendment will impact reported GAAP (and perhaps non-GAAP) results.

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Disclosure: David Trainer, Kyle Guske II, and Matt Shuler receive no compensation to write about any specific stock, sector, style, or theme.

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Key quotes from the paper:

- "[New Constructs'] *Total Adjustments* differs significantly from the items identified and excluded from Compustat's adjusted earnings measures. For example… 50% to 70% of the variation in *Total Adjustments* is not explained by *S&P Global's (SPGI) Adjustments* individually." – pp. 14, 1st para.
- "A final source of differences [between New Constructs' and S&P Global's data] is due to data collection oversights…we identified cases where Compustat did not collect information relating to firms' income that is useful in assessing core earnings." – pp. 16, 2nd para.

Superior Models

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Key quotes from the paper:

- "…an accurate calculation of ROIC requires more diligence than often occurs in some of the common, off-the-shelf ROIC calculations. Only by scouring the footnotes and the MD&A [as New Constructs does] can investors get an accurate calculation of ROIC." – pp. 8, 5th para.
- "The majority of the difference…comes from New Constructs' machine learning approach, which leverages technology to calculate ROIC by applying accounting adjustments that may be buried deeply in the footnotes across thousands of companies." – pp. 4, 2nd para.

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- "the portfolios formed following the buy recommendations of Robo-Analysts earn abnormal returns that are statistically and economically significant." – pp. 6, 3rd para.
- "Our results ultimately suggest that Robo-Analysts are a valuable, alternative information intermediary to traditional sell-side analysts." – pp. 20, 3rd para.

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