February 14, 2018

Mr. Russell Golden, Chairman
Mr. James Kroeker, Vice Chairman
Ms. Christine Ann Bostosan, Board Member
Ms. Marsha Hunt, Board Member
Mr. Harold Monk, Jr., Board Member
Mr. R. Harold Schroeder, Board Member
Mr. Marc Siegel, Board Member

Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Board Members:

We are writing to express our concern regarding the pending accounting change for commercial paper conduits, as per Accounting Standards Update 2016-15, Statement of Cash Flows (“ASU 2016-15”).

By way of background, Glenview Capital Management is a New York City based asset manager, founded in 2000, that manages approximately $11 billion with a fundamental research focus and a medium to long-term orientation. The two authors of this letter, Glenview’s CEO and our Director of Accounting Research each earned their CPA distinctions (which have since lapsed due to changes in our professional focus) and we have great respect for the need for financial statements to balance complexity with comparability to produce fair and accurate representations of corporate health and performance.

We are concerned the new rule in ASU 2016-15 will materially change the way many companies report operating cash flows, which will result in an uneconomic representation of the earnings process. Simply put, we believe this rule will have two undesirable and unintended consequences:

a) Companies will terminate the use of commercial paper conduits in favor of higher cost alternatives simply to avoid the optical decline in operating cash flow that the rule leads to, thus increasing the cost of capital for US corporations and diminishing their long-term corporate health, growth and job creation prospects; and/or
b) Investors will find GAAP statements further “unrealistic” in their characterization of a company’s cash flows and earnings and will tilt further to “adjusted” measures of performance. This dynamic encourages unhealthy creativity from companies as the investment community drifts away from, or in this case are driven away from, core accounting principles expressed through GAAP statements.

1 Specifically, we are concerned about Issue 7: Beneficial Interests in Securitization Transactions, that amended Accounting Standards Codification 230-10-45-12.
Perhaps equally disturbing to us was the fact that this rule was made without investor feedback, which we understand is a dramatic departure from past practice and precedent for such a large change. We could find no argument, circumstance, or justification for why this rule should bypass procedures that traditionally include soliciting the feedback from investors. In our own discussions with investors and corporate issuers we found that they universally opposed these new measures. As such, we respectfully request that the Board delay the effective date of ASU 2016-15 to conduct additional due diligence on how investor usage of cash flow information will be impacted by the accounting change. After hearing from other investors on how the change will reduce the decision usefulness of the cash flow statement, we believe the Board may reconsider its position on this rule.

Cash flow from operations is an important straightforward metric that we and other investors use to evaluate a company’s earnings power. Operating cash flow is the critical input to calculating the established investor metric of free cash flow, which is cash flow from operations less capital expenditures. Many companies use commercial paper conduits to sell receivables as a low-cost funding source, which we view as low-risk and smart financial management. We view all collections of receivables—both the receipt directly from the customer and through the commercial paper conduit—as the end of an earnings process, and think all collections should be reflected as an operating activity.

ASU 2016-15 is a material change to how companies present the collection of receivables sold through a commercial paper conduit. In many cases, we have found that the new presentation obfuscates the underlying operating performance of the company by classifying the collection of nearly all receivables as investing cash inflows. We understand that the change was made with the intention of aligning diversity in practice, but we have yet to observe a company that presented a material amount of securitized receivables in cash flow from investing. A big four audit firm has also indicated that they have not seen any material diversity in practice. On the contrary, we have observed companies with over a trillion dollars in combined market capitalization that would reclassify billions out of operating cash flow as a result of the change.

For example, Kraft Heinz early-adopted the change in 2017, which has resulted in a 99% decline in GAAP reported operating cash flow, meaning the change reduced operating cash flows to $16m from $1.6b. We are not investors in Kraft Heinz, but we became aware of the change when we noticed that, as per Bloomberg, the company generated no year-to-date 2017 free cash flow. Most analysis tools, including Bloomberg and FactSet, are not set up to recognize cash inflows from investing cash flow in their standardized measure of free cash flow. These standardized measures are important inputs that investors use to screen for value and generate new ideas. We would also note that these standardized measures are used by algorithmic trading platforms – while we do not trade this way and are happy to be presented investment opportunities by their mechanistic formulas that may lead them to illogical conclusions, we believe it would be more responsible to ensure that their inputs are sound and consistent with long-standing matching principles that fairly account for cash flow generated from operating and investing activities.

As fundamental financial analysts, we can make adjustments to the cash flow statement to reflect this change; however, this adds unnecessary complexity to an otherwise straightforward reported measure. Investors are not accustomed to looking to investing cash flows as a source of cash. It also seems investors would need to be technical accountants to understand why they are looking to investing cash flows to observe the end of an earnings process.
We are aware of at least one company in the S&P 500 that has cancelled their commercial paper conduit. We believe this cancellation was due to the accounting change and think other companies will follow suit. The accounting change leads us to believe that companies will choose to either a) replace this low-cost funding source with a higher-cost source; or b) report “non-GAAP” operating cash flow. We prefer our companies to make economic-based decisions and not accounting-based decisions, which means we prefer a non-GAAP figure. However, this means that the GAAP cash flow statement is less relevant, as it will no longer be the starting point for evaluating earnings power.

We appreciate that the FASB takes great care to solicit investor feedback on important accounting changes, which is why we were surprised to learn that no investor feedback was sought before this change was made. We reviewed the due process documents for ASU 2016-15, and it seems the magnitude of the change—made by the Emerging Issues Tax Force as part of a minor multi-part cash flow presentation update—may not have been fully appreciated by the FASB Staff. We also wonder whether the alternative presentation options were thoroughly vetted. In reviewing the comment letters submitted by non-financial companies on this issue, we did not find any companies that were in support of this change.

We realize it’s possible that the effects of the change were not well-understood at the time the decision was made which is why we are including, as an appendix, a summary of how the change is being implemented as per PricewaterhouseCoopers. Based on the summary, it is difficult for us to rationalize why, depending on the amount receivables sold and collected in a single day, some cash collections would be classified in investing instead of operating cash flows.

Given the magnitude of the change, it would seem accounting for these commercial paper facilities would benefit from a more rigorous pre-implementation review that includes investor feedback. We believe investors’ practical concerns about presentation changes for the monetization of receivables should outweigh any minor conceptual accounting concerns. As noted by companies that submitted letters, there seem to be alternatives that would better reflect the earnings process and still remove any perceived diversity in practice.

We understand that as standard setters, you have the challenging task of considering the views of many constituents. Given that both companies and investors are aligned in how commercial paper conduits should be reflected in financial statements, it is our hope that the Board delay the effective date of ASU 2016-15. A delay would allow time to complete additional due diligence that would enable Board Members to overturn the decision in ASU 2016-15, ensuring the cash flow statement continues to reflect the economic substance of transactions, as evaluated by companies and their investors. We are available to further discuss our views if you have any questions. Thank you for your time and consideration.

Respectfully,

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Director of Accounting Research
Former CPA, 2011 (NC)