Industrial Development Funding, LLC

Product Sales Funding GAAP & IFRS Accounting White Paper

January 18th, 2022

Background

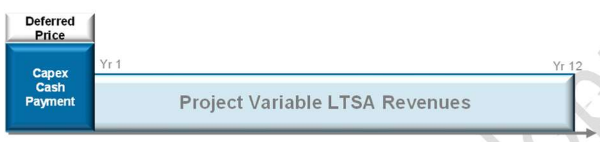
Industrial Development Funding, LLC (“IDF”), engages with leading Industrial companies to arrange investor groups to share development and infrastructure costs in exchange for future project-level cash flows that are key to the Industrial’s strategy and growth. IDF will arrange for Industrial companies to partner with various investors to provide upfront funding options for equipment sales to Customers, deferring the Customer’s payments. Repayments to the investor are made from the deferred payments by the Customer, improving the Customers cash flow profile. Investment has no recourse to Industrial and no asset liens are required. Program intended to:

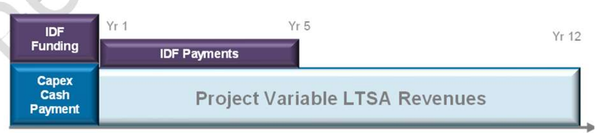
A. Support upgrades to existing infrastructure
B. New equipment Sales

Example:

Before: Customer funds upfront for new capex at low/no margin for industrial and pays higher margin long-term service agreement (LTSA).

After: Customer issues long-term 5 year payable upfront for capex. IDF purchases payable in exchange for 5-year fixed repayment post COD





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Issue being resolved

Industrial companies sell equipment at low margins (or even at losses) in exchange for future service revenue on the equipment at much higher margins. IDF funding product allows Industrial to win more business while retaining more price and cash flow in upfront sale of equipment versus deferral over time in future service cash flows, via off-balance sheet sale of receivables to IDF

Benefits to Industrial

- Program partner relationship to win more deals at higher price
- Increases equipment or service revenue / operating cash
- Transfers Customer credit risk
- Reduces balance sheet exposure
- Simple execution via existing equipment service documentation

Benefits to Customer

- Maximizes debt plus mezzanine financing of the project in a one-stop shop for equipment and long-term payment deferrals
- Simple documentation through existing Service Agreements
- Alignment of long-term interests of strategic supplier with project owner
- Better matching of revenue and expenses
- Improved working capital / balance sheet metrics
- Easy refinance once assets are operating

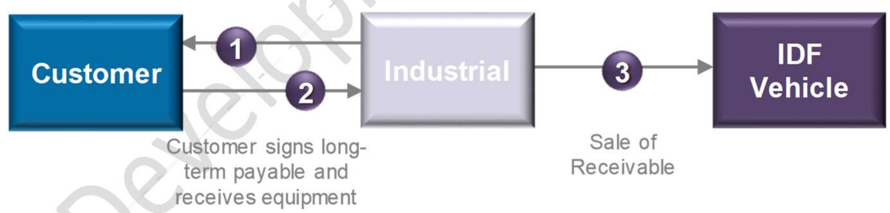
Benefits to Investor

- Attractive risk adjusted returns, embedded in critical operating contracts
- Scale deployment alongside top global Industrial
- Efficient collections via Industrial servicing network
- Returns with low correlation to traditional financial markets
- Invests in self-liquidating instrument
- Programmatic documentation via master purchase agreements

Structure

New Equipment & Upgrades Product Sales Funding (PSF)

- Customer signs portion of long-term payable to Industrial for portion of upfront capex
- Payable is documented in long-term service agreement 5-year repayment
- See Exhibit 1 for T-Accounting



Transactional Steps

1. Industrial provides equipment to Customer
2. Industrial provides deferred payment terms that are structured so that the deferred repayment amount (principal amount deferred plus a premium for deferral, calculated at a market risk-adjusted rate is re-paid by year 5), By agreeing to the long-term payable the Customer allows the Industrial to create a receivable (for the principal plus premium amount), which can be sold to a third-party
3. IDF purchases the receivable from the Industrial for the principal amount, allowing the Industrial to record cash and revenue for the equipment provided. IDF would then receive the deferred payments (principal plus premium) by year 5[1].

[1] Note that IDF offers up to 8 year tenor, and option for variable payment structure based on the project usage

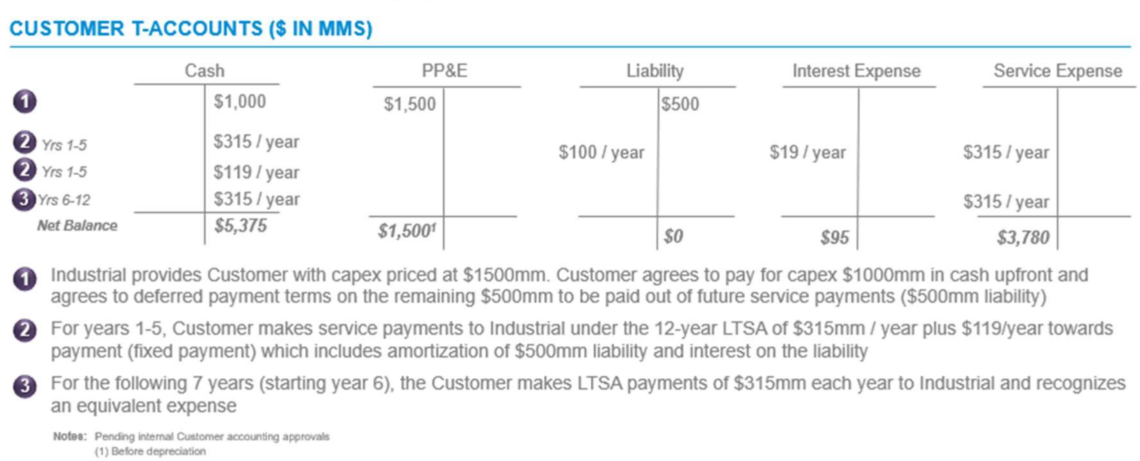
New Equipment Pricing Process

In certain scenarios, the Industrial may require funding for the sale of new equipment to a Customer where the agreement of the funding occurs multiple months before the funding is to take place. Below is the process of determining any changes that may occur from the funding agreement date to the actual funding date:

Major Changes to Purchase Agreement
The major changes to the Purchase Agreement for a new unit financing are expected to be as follows:

1. Staggered funding ("Signing Date" vs. "Purchase Date")
   a. Purchaser will agree to a price at equipment selection that is structured as a fixed spread to an agreed upon index (for a base load gas turbine power plant, the spread may be a BBB credit spread)
   b. Conditions to "Signing Date" and "Purchase Date" will include the deliverables required to be shared by Customer in the lead-up to financial close. These conditions should be similar and consistent with the senior secured financing conditions.
2. Price/Payment Adjustments)
   a. When the underlying project is completed and begins Cash generation: spread to index will be converted to an annual interest rate to achieve target return

Exhibit 1: Customer T-Accounting – SF



INDUSTRIAL T-ACCOUNTS ($ IN MMS)

	Cash		Inventory		Accounts Receivable		Revenue		COGS		Contra-Revenue	
1				$1,500					$1,500			
2	$1,500[2]				$500	$500		$1,500				
3 Yrs 1-5	$315 / year	$119 / year						$315 / year			$119 / year	
3 Yrs 1-5	$119 / year							$119 / year				
4 Yrs 6-12	$315 / year							$315 / year				
	$5,280			*$1,500*		*$0*		*$5,875*	*$1,500*		*$595*	

1. Industrial provides capex turbines that cost $1,500mm in cash to the Customer(with a contract price of $1,595mm including a deferral of $95mm)
2. Industrial provides deferred payment terms in which the Customer will pay $1,000mm cash upfront and agree to pay $595mm over 5 years (deferred payment terms on $500mm over 5 years). Industrial sells receivable to IDF for $500mm upfront
   - *$1,500mm revenue = $1,000mm cash upfront + $500mm (discounted value of $595mm)*
3. Years 1-5, Customer makes $315mm / year in service payments[1] to lock-box as part of the service agreement. Industrial distributes $119mm / year to IDF as terms for the sale of the receivable and records contra-revenue
4. Years 6-12, Customer makes $315mm / year in service payments to Industrial as part of the service agreement. Industrial retains entire amount

Notes: Pending internal Industrial accounting approvals
(1) Industrial acts as servicer / collector of payments
(2) Consists of $1,000mm upfront cash from Customer and $500mm purchased amount from IDF

Accounting Considerations

While the benefits of Product Sales Funding arrangement have been outlined above, Industrial should also consider the related accounting impacts of the arrangement as the transfer of the receivable could have differing accounting recognition outcomes: secured borrowing, sale of financial asset, presentation differences, etc.

The following outlines the accounting considerations for these arrangements in accordance with U.S. Generally Accepted Accounting Principles ("US GAAP") Accounting Standard Codifications ("ASC") as detailed below.

Specific facts and circumstances for each Product Sales Funding program will need to be considered to determine the appropriate accounting and financial reporting for such arrangements.

Accounting Guidance

- ASC 230 *Statement of cash flows*
- ASC 810 *Consolidation*
- ASC 860 *Transfers and servicing*
- IFRS 9 *Financial instruments*
- IFRS 10 *Consolidated Financial Statements*

Accounting Questions

1. Should Industrial consolidate the Investor under the guidance in ASC 810?
2. Does the receivable meet the definition of a financial asset under ASC 860? If so, does the transaction meet the definition of a transfer?
3. Does the guidance on participating interest in ASC 860 apply to Industrial's receivable transfer?
4. Does the transfer of the receivable satisfy the sale criteria in ASC 860?
5. What is the cash flow statement presentation of the transaction upon sale and post-sale?

These accounting issues follow the flowchart in PwC Transfers and servicing of financial assets guide ("PwC TS Guide"); see Appendix 1.

Question 1: Should Industrial consolidate the Investor under the guidance in ASC 810 [IFRS 10]?

Industrial's consideration of ASC 860 may be an unnecessary exercise if the entity is required to consolidate the Investor based on applying the guidance in ASC 810. If the Investor is included in the consolidated financial statements of Industrial, the transferred assets continue to be reported on the consolidated entity's balance sheet, and beneficial interests in those assets held by third parties are reported as liabilities.

Per ASC 860-10-55-17D, if all other provisions of ASC 860 are met with respect to a transfer, and the Investor would be consolidated by Industrial, then the transferred receivable would not be treated as having been sold in the financial statements being presented. However, if the Investor is a consolidated subsidiary of Industrial (its parent), the Investor shall recognize the transferred financial assets in its separate entity financial statements, unless the nature of the transfer is a secured borrowing with a pledge of collateral (for example, a repurchase agreement that would not be accounted for as a sale under the provisions of paragraph 860-10-40-24).

The purchaser of the receivable will be a newly formed special purpose entity ("SPE"), managed and controlled by the investor. Even though Industrial does not hold an equity interest in the SPE, Industrial must evaluate whether the SPE should be consolidated. If the SPE is not consolidated, then ASC 860 may be applied to the creation of the receivable by Industrial and Customer, and the subsequent transfer of the receivable from Industrial to the unconsolidated SPE. The consolidation guidance under ASC 810 prescribes two primary models for determining consolidation treatment; the variable interest entity ("VIE") model and the voting interest entity model. Considerations for both models will be considered for this section.

VIE Model

Step 1: Do any scope exceptions at ASC 810-10-15-12 or 15-17 apply?

The SPE will be evaluated as a legal entity and the scope exceptions from applying the VIE model are evaluated as follows:

a. Not for profit entities
b. Separate accounts of life insurance entities
c. Lack of information
d. Business scope exception
e. Employee benefit plan
f. Investment company
g. Governmental organization
h. Money market funds (or similar type of investment company) subject to Rule 2a-7 of the Investment Company Act of 1940.

Analysis:

None of the above scope exceptions (a-h) apply.

Step 2: Does Industrial have a variable interest in the SPE?

ASC 810-10-20 defines variable interest as:

> *Investments or other interest that will absorb portions of a variable interest entity's (VIE's) expected losses or receive portions of the entity's expected residual returns. Variable interests in a VIE are contractual, ownership, or other pecuniary interest in a VIE that change with changes in the fair value of the entity's net assets exclusive of variable interests.*

Industrial must first determine whether it has a variable interest in the SPE being evaluated for consolidation. If Industrial concludes it holds a variable interest in the SPE, it must then evaluate whether the SPE is a VIE. Equity interests, guarantees, subordinated debt interest, derivatives, management contracts, leases and written call options are all variable interests because they absorb risk created and distributed by an entity.

Analysis:

The Industrial has no variable interest in the SPE, and therefore need not evaluate whether the SPE is a VIE. *Step 3: Is the SPE a VIE?*

A VIE is an entity that by design possess any one of the following characteristics (as provided under ASC 810-10-15-14):

a. The equity investment at risk is not sufficient for the entity to finance its activities without additional subordinated financial support; or
b. As a group, the holders of equity investment at risk do not possess:
    1. The power, through voting rights or similar rights, to direct the activities that most significantly impact the entity's economic performance; or
    2. The obligation to absorb expected losses or the right to receive the expected residual returns of the entity; or
    3. Symmetry between voting rights and economic interests and where substantially all of the entity's activities either involve or are conducted on behalf of an investor with disproportionately fewer voting rights (e.g., structures with non substantive voting rights).

Industrial performed the VIE assessment of the aforementioned characteristics as follows:

VIE criteria	Applicability to the SPE
The entity does not have enough equity at risk to finance its activities without additional subordinated financial support	The entity does not require additional subordinated financial support.
Equity lacks decision making rights over the activities that most significantly impact the entity's economic performance	Equity maintains decision making rights over the activities that most significantly impact the entity's economic performance
Equity with non-substantive voting rights	Equity maintains all the voting rights of the SPE
Equity holders lack the obligation to absorb an entity's expected losses	Equity maintains the obligation to absorb an entity's expected losses
Equity holders lack the obligation to absorb an entity's expected losses	Equity maintains the obligation to absorb an entity's expected residual returns

Step 4: If the SPE is a VIE, is Industrial the primary beneficiary of the SPE?

If the SPE is considered a VIE, there is an analysis required to determine whether any parties involved with the SPE have a controlling financial interest in the SPE, and therefore are considered the primary beneficiary, and are be required to consolidate the SPE.

ASC 810-10-25-38A provides that Industrial is deemed to be the primary beneficiary if it meets both criteria below:

a. Power Criterion: Power to direct activities of the VIE that most significantly impact the VIE's economic performance.
b. Losses/Benefits Criterion: Obligation to absorb losses from or the right to receive benefits of the VIE that could potentially be significant to the VIE.

Only one reporting entity (if any) is expected to be identified as the primary beneficiary of a VIE. Although more than one reporting entity could meet the losses/ benefits criterion, only one reporting entity (if any) will have the power to direct the activities of a VIE that most significantly impact the VIE's economic performance.

Analysis:

The Industrial does not have the power to direct activities of the VIE that most significantly impact the VIE's economic performance and therefore not deemed to be the primary beneficiary.

VOE Model

Upon concluding that the SPE is not consolidated by Industrial under the VIE model, Industrial must assess whether the receivable within the SPE falls within the scope of the VOE consolidation model.

Under the VOE model in ASC 810-10-15-8, a controlling financial interest is ownership of a majority voting interest; therefore, as a general rule, ownership by one reporting entity (directly or indirectly) of more than 50 percent of the outstanding voting shares of another entity demonstrated a controlling financial interest, with certain exceptions. Several factors must be considered to determine if voting control exists. An assessment of whether voting control exists is based on all of the facts and circumstances surrounding the relationship(s) between the parties (both direct and indirect).

Analysis:

The Industrial does not maintain ownership by one reporting entity (directly or indirectly) of more than 50 percent of the outstanding voting shares of another entity demonstrated a controlling financial interest and therefore does not fall within the scope of the VOE consolidation model.

Question 2: Does the receivable meet the definition of a financial asset under ASC 860 **[IAS 32 Paragraph 11]*****? If so, does the transaction meet the definition of a transfer?***

Financial Asset

ASC 860-10-20 **[IAS 32 Paragraph 11]** defines a financial asset as:

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a) *Receive cash or another financial instrument from a second entity*
b) *Exchange other financial instruments on potentially favorable terms with the second entity.*

The receivable satisfies the definition of a financial asset as the receivable is a contract that conveys to one entity (i.e., the SPE) the right to receive cash from a second entity (the customer of Industrial).

Transfer of a financial asset

If the receivable meets the definition of a financial asset, Industrial must assess whether the transaction meets the definition of a transfer. ASC 860-10-20 **[IFRS 9 3.2.3 to 3.2.6 and Appendix B3.2.4 to B3.2.5]** defines a transfer as:

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset.

A transfer includes the following:

a) *Selling a receivable*
b) *Putting a receivable into a securitization trust*
c) *Posting a receivable as collateral*

A transfer excludes the following:

a) *The origination of a receivable*
b) *Settlement of a receivable*
c) *The restructuring of a receivable into a security in a troubled debt restructuring*

ASC 860-10-05 **[IFRS 9 Appendix B3.2.4]** discusses transactions involving transfers of financial assets that fall within the scope of ASC 860 **[IFRS 9 3.2]**, including transfers of entire receivables or loans to an investor (with or without recourse) and transfers of entire receivables or loans to a securitization entity that issues beneficial interests to third-party investors.

The transfer involves the selling of a receivable by the Industrial to the SPE. The receivable is originated between the Industrial and the Customer of the Industrial. As such, the transaction meets the definition of a transfer of a financial asset.

Scope exceptions

Lastly, Industrial must consider whether the transfer meets any of the scope exceptions per ASC 860-10-15-4 **[IFRS 9 2.1]**, which identifies specific transactions and activities outside of the scope of ASC 860 including:

a) Except for transfers of servicing assets (see Subtopic 860-50-40) and for the transfers noted in the following paragraph, transfers of nonfinancial assets
b) Transfers of unrecognized financial assets, for example, lease payments to be received under operating leases
c) Transfers of custody of financial assets for safekeeping
d) Contributions (for guidance on accounting for contributions, see Subtopic 958-605)
e) Transfers of in-substance nonfinancial assets, see Subtopic 610-20
f) Investments by owners or distributions to owners of a business entity
g) Employee benefits subject to the provisions of Topic 712
h) Leveraged leases subject to Topic 842
i) Money-over-money and wrap lease transactions involving nonrecourse debt subject to Topic 842.

Not applicable – none of the above scope exceptions apply to the arrangement. As such, Industrial will consider the remaining questions below.

Question 3: Does the guidance on participating interests in ASC 860* [IFRS 9 3.2] *apply to Industrial's receivable transfer?

ASC 860-20-20 **[IFRS 9 3.2.2]** defines transferred financial assets as transfers of any of the following:

a) An entire financial asset
b) A group of entire financial assets
c) A participating interest in an entire financial asset

If the sale of the receivable results in Industrial retaining the rights and title to the receivable and selling an interest in the receivable, then the transfer would be evaluated as a sale of a participating interest in an entire financial asset rather than a sale of the entire financial asset itself. If the former, then the definition of participating interest must be met before sale criteria can be evaluated. If the latter (i.e., transfer involves an entire financial asset), then the ASC 860 **[IFRS 9 3.2]** sale criteria is applied.

A transfer of a participating interest in an entire financial asset result from a transaction in which something less than full title and ownership of the underlying financial assets subject to the transaction is legally transferred to the transferee and only if the specified criteria in ASC 860-10-40-6A **[IFRS 9 3.2.2(a)]** are met. Per ASC 860-10-40-4E **[IFRS 9 3.2.2]**, the above guidance requires that only entire financial assets, group of entire financial assets, or participating interests in entire financial assets be subjected to the three broad criteria in ASC 860-10-40-5 **[IFRS 9 3.2.3 to 3.2.9]**. That is, a transfer of a portion of a financial asset, when that portion does not meet the definition of a participating interest, would not qualify as a sale, even if it meets the conditions in ASC 860-10-40-5 **[IFRS 9 3.2.3 to 3.2.9]**. In such cases, Industrial shall account for the transfer as a secured borrowing with a pledge of collateral per the guidance at ASC 860-30-25-2 **[IFRS 9 3.2.14 to 3.2.15]**. Refer to **[IFRS 9 3.2.2(a) and 3.2.13 to 3.2.14]** for guidance involving transfers of assets which are part of a larger group of assets.

This issue addresses whether the transferred financial asset is an entire financial asset. As noted in PwC TS Guide 2.3:

> *As a general rule, an entire financial asset (or a group of entire financial assets) should be considered transferred when full title to, and ownership of, the financial asset is conveyed to the transferee. That is, as a result of the transfer, the transferee now holds legal title to the asset and, as a consequence, can exercise the rights (and must observe any obligations) prescribed in the underlying assigned contract or instrument negotiated with its issuer. However, as discussed in the following section, to conclude that a transfer involves an entire financial asset, conditions in addition to the conveyance of legal ownership to the transferee may also need to be satisfied.*

Analysis:

In all cases, the entire financial asset will be sold and transferred, and control will belong to the transferee/IDF/investor. In the IFRS case, all the risks and rewards of the financial asset will belong to transferee/IDF/investor. Transfers involving loans and loans consisting of multiple advances is not applicable to the sale of this receivable, therefore implementation of ASC 860-10-55-17 F-H is unnecessary.

Question 4: Does the transfer of the receivable satisfy the sale criteria under ASC 860* [IFRS 9 3.2]*?

In order to achieve sale accounting (and thus off-balance sheet treatment for transferred receivables), ASC 860-10-40-5 **[IFRS 9 3.2.3 to 3.2.9]** outlines control conditions that must be met:

a) *Isolation of transferred financial assets;*
b) *Transferee maintains the right to pledge the financial assets; and*
c) *The transferor does not retain "effective control"*

Only if all three criteria are met, can the transferred financial assets be derecognized. Failure to meet any one of the above criteria would prevent Industrial from derecognizing the transferred financial assets and would require the transaction to be accounted for as a secured borrowing. Important considerations for each of these conditions are noted below.

Condition 1: Isolation of Transferred Financial Assets

Per ASC 860-10-40-5(a) **[IFRS 9 3.2.6 to 3.2.8]**:

> *The transferred financial assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership. Transferred financial assets are isolated in bankruptcy or other receivership only if the transferred financial assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its consolidated affiliates included in the financial statements being presented.*

Derecognition of transferred financial assets is allowed only if available evidence provides reasonable assurance that the transferred financial assets have been put presumptively beyond the reach of the powers of (1) a bankruptcy trustee or (2) other creditors of Industrial or any consolidated affiliate of Industrial. The best form of evidence to demonstrate reasonable assurance that the legal isolation criterion has been satisfied is a legal opinion.

The evaluation of whether this requirement has been met should be based on an analysis of the legal considerations of the terms of the sale. Sales of financial assets with continuing involvement by Industrial, including servicing, repurchase agreements, various forms of recourse, and ownership interests will require a detailed analysis and will need to be performed by a legal expert.

Analysis:

The receivable has been irrevocably transferred, legally isolated from Industrial (even in the event of bankruptcy). Legal opinion as to sales treatment will be provided confirming above.

Condition 2: Transferee's Rights to Pledge or Exchange

As described in ASC 860-10-40-4 **[IFRS 9 3.2.16]**, a transferor's sale accounting analysis should take into account its "continuing involvement" with the transferred financial assets. This assessment should consider not only the transferor's involvement, but also those of its consolidated affiliates and agents. When making this determination, all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer should be considered. The condition at ASC 860-10-40-5(b) **[IFRS 9 3.2.9]** is met if both of the following conditions are met:

1. *Each transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset-backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received.*
2. *No condition does both of the following:*
   i. *Constrains the transferee (or third-party holder of its beneficial interests) from taking advantage of its right to pledge or exchange.*
   ii. *Provides more than a trivial benefit to the transferor (see paragraph 860-10-40-15 through 40-21)*

Constraints on Investor's contractual right to pledge or exchange transferred financial assets may be explicitly imposed within the transfer documents or they may be inherent to the market or industry in which the assets reside.

Analysis:

Upon completion of a transfer, the transferor and transferee must determine whether, in fact, the transferee (or, if the transferee is an entity whose sole purpose is to engage in securitization or asset backed financing activities and that entity is constrained from pledging or exchanging the assets it receives, each third-party holder of its beneficial interests) is able to freely pledge or exchange the assets (or beneficial interests). If the transferee (or holder) is not constrained from doing so, then the criterion is met. Conversely, if the transferee (or holder) is constrained by the transferor, a consolidated affiliate, or an unaffiliated agent, and that constraint provides more than a trivial benefit to the transferor, sale treatment for the transfer would be precluded. The receivable can be pledged or exchanged to a third-party. Once the industrial sells the receivable they have no right to the financial asset. Servicing of the asset will be provided by the Industrial, however it will not consist of any incremental servicing already provided by the Industrial in absence of the financial asset. The transferee (or holder) is not constrained by the transferor, a consolidated affiliate, or an unaffiliated agent, and therefore the Industrial may receive sale treatment.

Condition 3: Effective Control

Per ASC 860-10-40-5(c) **[IFRS 9 3.2.7]**, effective control over the transferred financial assets includes, but is not limited to, any of the following:

1. *An agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (see paragraphs 860-10-40-23 through 40-27)*
2. *An agreement, other than through a cleanup call (see paragraphs 860-10-40-28 through 40-39), that provides the transferor with both of the following:*
   i. *The unilateral ability to cause the holder to return specific financial assets*
   ii. *A more-than-trivial-benefit attributable to that ability*
3. *An agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them (see paragraph 860-10-55-42D).*

Industrial may maintain effective control directly (i.e., as a result of a specific contractual provision) or indirectly (i.e., through a combination of contractual arrangements that, when considered together, provide effective control). Accordingly, when evaluating this criterion, Industrial must consider all forms of continuing involvement with the receivables (including, if applicable, involvements with third-party beneficial interests in those transferred assets). This analysis should also take into account involvements on the part of Industrial's consolidated affiliates and agents.

Analysis:

It is at the discretion of both parties whether the financial asset will be sold back to the Industrial/transferor. Neither party is obligated to purchase or sell the financial asset to the other party after initial sale of the financial asset.

If all of the above criteria at ASC 860-10-40-5 **[IFRS 9 3.2.3 to 3.2.9]** are met to be accounted for as a sale, per ASC 860-20-40-1B **[IFRS 3.2.10 to 3.2.14]**, Industrial shall:

a. Derecognize the transferred financial assets,
b. Apply the guidance in paragraphs 860-20-25-1 and 860-20-30-1 on recognition and measurement of assets obtained and liabilities incurred in the sale (refer to Appendix),
c. Recognize in earnings any gain or loss on the sale.

If one of the above criteria at ASC 860-10-40-5 **[IFRS 9 3.2.3 to 3.2.9]** are not met, the transfer is to be accounted for as a secured borrowing per ASC 860-30-25-2 **[IFRS 9 3.2.15]**.

As all of the above criteria at ASC 860-10-40-5 **[IFRS 9 3.2.3 to 3.2.9]** are met, and therefore the transfer is not to be accounted for as a secured borrowing but rather as a sale of a financial asset.

Question 5: What is the cash flow statement presentation of the transaction upon sale and post-sale?

Per ASC 230-10-45-16(a) **[IAS 7 Paragraphs 13 to 15]**, all of the following are cash inflows from operating activities:

a. *Cash 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 include 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.*
b. *Cash receipts from returns on loans, other debt instruments of other entities, and equity securities—interest and dividends.*
c. *All other cash receipts that do not stem from transactions defined as investing or financing activities, such as amounts received to settle lawsuits; proceeds of insurance settlements except for those that are directly related to investing or financing activities, such as from destruction of a building; and refunds from suppliers.*

PwC financial statement presentation guide (“PwC FSP Guide”) section 6.7.3 states: “Common examples of operating cash flows are: … Receipts from customers for sales of goods and/or services, as well as receipts from short-term and long-term receivables under normal trade terms that arose from sales of goods and/or services …”

PwC FSP Guide section 6.7.2 states: “The following items should be classified as financing activities: …Cash inflows and outflows associated with repurchase agreements, including transactions accounted for as a securitized borrowing. Net presentation for these cash flows may be permitted.

The financial asset sold should be considered a “collection or sale of accounts and both short- and long-term notes receivable from customers arising from those sales”. Therefore, the sale of the receivable/financial asset to IDF/investor/transferee/purchaser should be classified as an operating cash flow.

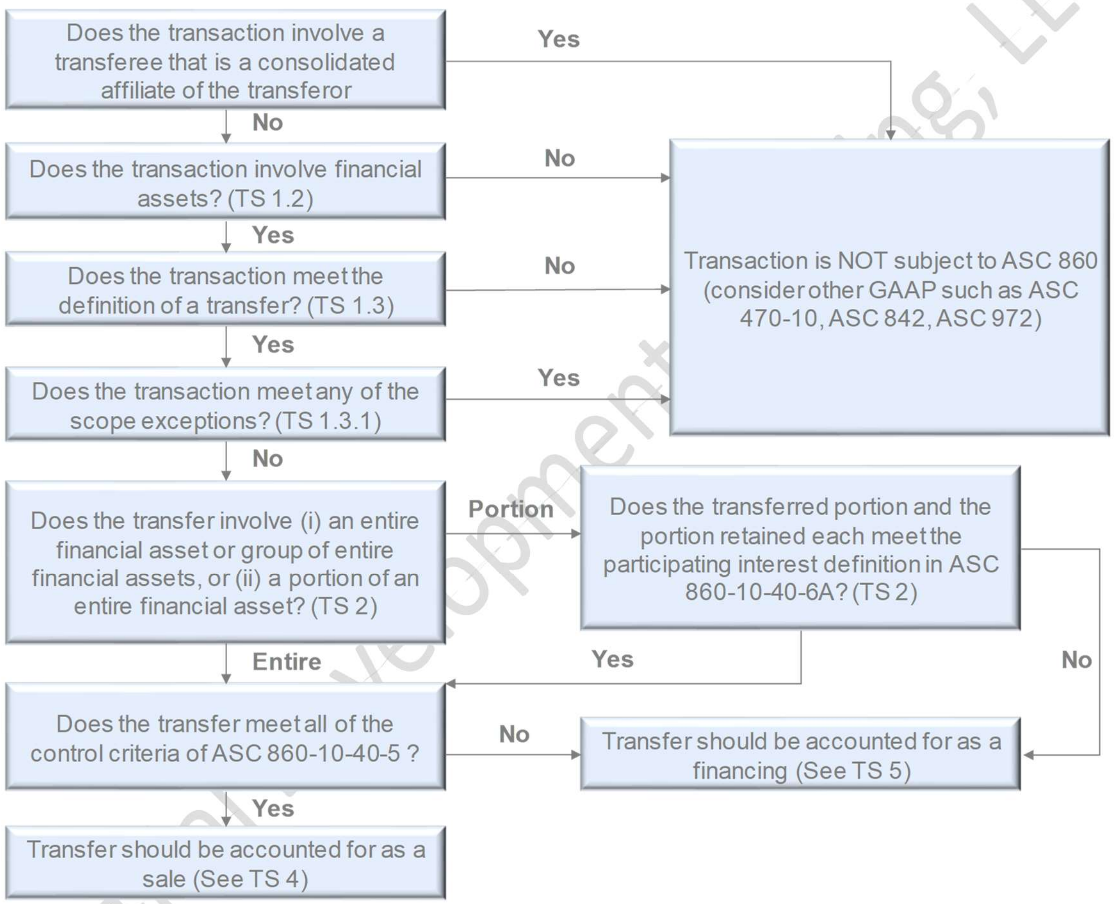
Product Sales Funding Example

	Without IDF Product Sales Funding	With IDF Product Sales Funding
Book Value of Product	$1,500mm	$1,500mm
Upfront Cash Paid by Customer	$1,500mm	$1,000mm
Upfront Liability Assumed by Customer	$0mm	$500mm
Interest Paid by Customer over Liability Life	$0mm	$95mm
Estimated Amortization Period of Liability	N/A	5 years
IDF Funding Amount	$0mm	$500mm
Total Upfront Cash Received by Industrial for Product	$1,500mm	$1,500mm
Customer Service Payments over LTSA	$3,780mm	$4,375mm
Service Payments Re-directed to IDF	$0mm	$595mm
Total Cash Received by Industrial for Products and Services	$5,280mm	$5,280mm
IDF Repayments	N/A	$595mm
IDF IRR	N/A	6.0%
IDF Term	N/A	5 years
Protections		▪ Customer acknowledgement of receivables invoices sold ▪ No setoff or defenses of customers obligation ▪ UCC filed equipment receivable ▪ Payments embedded in LTSA expected over 5-year term

Appendix 1

Transfer framework

Figure 3-1
Framework for Accounting for Transfers of Financial Assets



IFRS 9 considerations

<table>
<tr><th>US GAAP</th><th>IFRS</th></tr>
<tr><td>ASC 860 does not apply to transfers in which the transferee is a consolidated affiliate of the transferor, as defined in the standard. If this is the case regardless of whether the transfer criteria are met, derecognition is not possible as the assets are, in effect, transferred within the consolidated entity.
The guidance focuses on an evaluation of the transfer of control. The evaluation is governed by three key considerations:
• Legal isolation of the transferred asset from the transferor
• The ability of the transferee (or, if the transferee is a securitization vehicle, each third-party beneficial interest holder) to pledge or exchange the asset (or the beneficial interest)
• The transferor has no rights or obligation to repurchase the transferred assets
As such, derecognition can be achieved even if the transferor has significant ongoing involvement with the transferred assets, such as significant exposure to credit risk.
If a transfer of an entire financial asset qualifies for sale accounting, the transferred asset must be derecognized from the transferor’s balance sheet. All assets received and obligations assumed in exchange are recognized at fair value.
If the transferor continues to service the transferred assets, a related servicing asset or servicing liability should be recorded at its fair value. Any gain or loss on the transfer should be recognized calculated as the difference between the net proceeds received and the carrying value of the assets sold.
A transfer may comprise only a portion of an entire financial asset (e.g., a transfer involving a loan participation). To potentially qualify for sale accounting, the transferred portion must first meet the stringent accounting definition of a “participating interest”. If the transferred portion does not satisfy this definition, the exchange must be accounted for as a secured borrowing. If the definition is met, the transfer of the participating interest must then satisfy the three derecognition criteria cited above to qualify for sale accounting.
If a transfer of a participating interest qualifies for derecognition, the transferor must allocate the carrying value of the entire financial asset between the participating interest sold and the portion retained on a pro-rata basis. All assets received and obligations assumed in exchange are recognized at fair value, consistent with the measurement principles that govern derecognition of an entire financial asset.</td><td>The transferor first applies the consolidation guidance and consolidates any and all subsidiaries or special purpose entities it controls.
The guidance focuses on evaluation of whether a qualifying transfer has taken place, whether risks and rewards have been transferred, and, in some cases whether control over the asset in question has been transferred.
The model can be applied to part of a financial asset (or part of a group of similar financial asset) or to the financial asset in its entirety (or a group of similar financial assets in their entirety).
Under IFRS 9, full derecognition is appropriate once both of the following conditions have been met:
• The financial asset has been transferred outside the consolidated group.
• The entity has transferred substantially all of the risks and rewards of ownership of the financial asset.
The first condition is achieved in of the two ways:
• When an entity transfers the contractual rights to receive the cash flows of the financial assets, or
• When an entity retains the contractual rights to receive the cash flows but assume a contractual obligation to pass the cash flows on to one or more recipients (referred to as a pass-through arrangement)
Many securitizations do not meet the strict pass-through criteria to recognize a transfer of the asset outside of the consolidated group and as a result fail the first condition for derecognition.
If there is a qualifying transfer, an entity must determine the extent to which it retains the risks and rewards of ownership of the financial asset. IFRS 9 requires the entity to evaluate the extent of the transfer of risks and rewards by comparing its exposure to the variability in the amounts and timing of the transferred financial assets net cash flows, both before and after the transfer.
If the entity’s exposure does not change substantially, derecognition would be precluded. Rather, a liability equal to the consideration received would be recorded (i.e. financing transaction). If, however, substantially all risks and rewards are transferred, the entity would derecognize the financial asset transferred and recognize separately any asset or liability created through any rights and obligations retained in the transfer (e.g. servicing assets).
Many securitization transactions include some ongoing involvement by the transferor that causes the transferor to retain substantial risks and rewards, thereby failing</td></tr>
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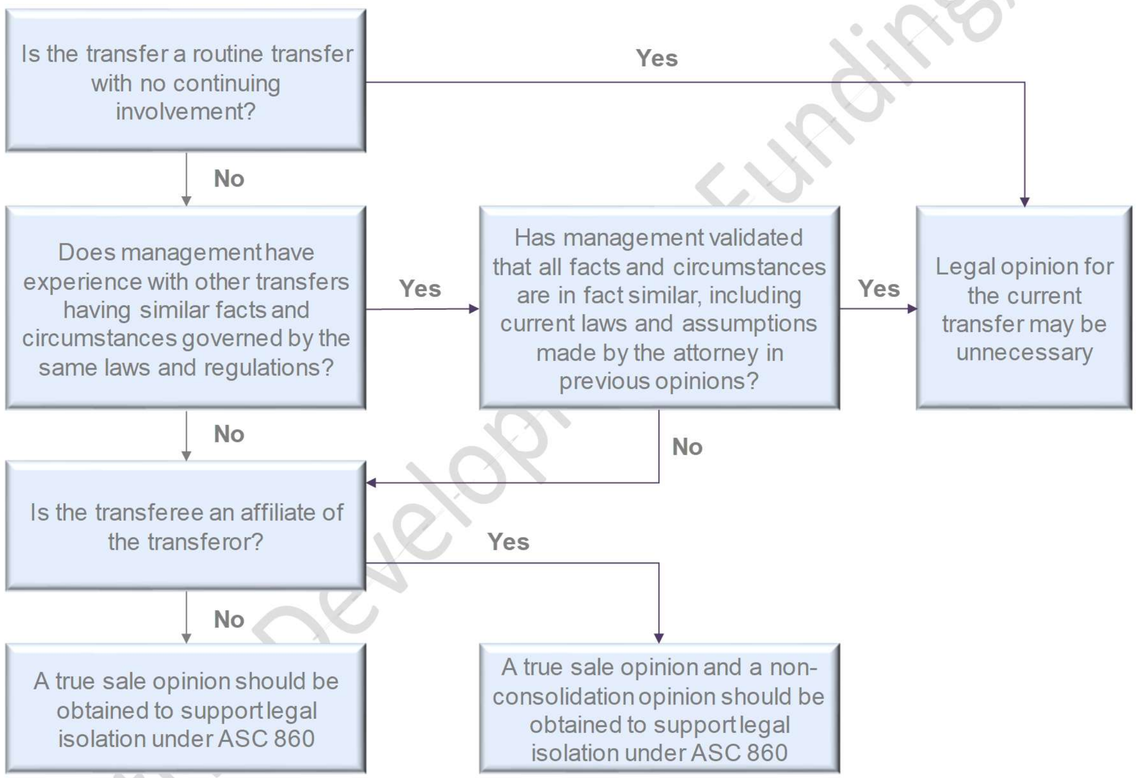
	the second condition for derecognitions, even if the pass-through test is met.

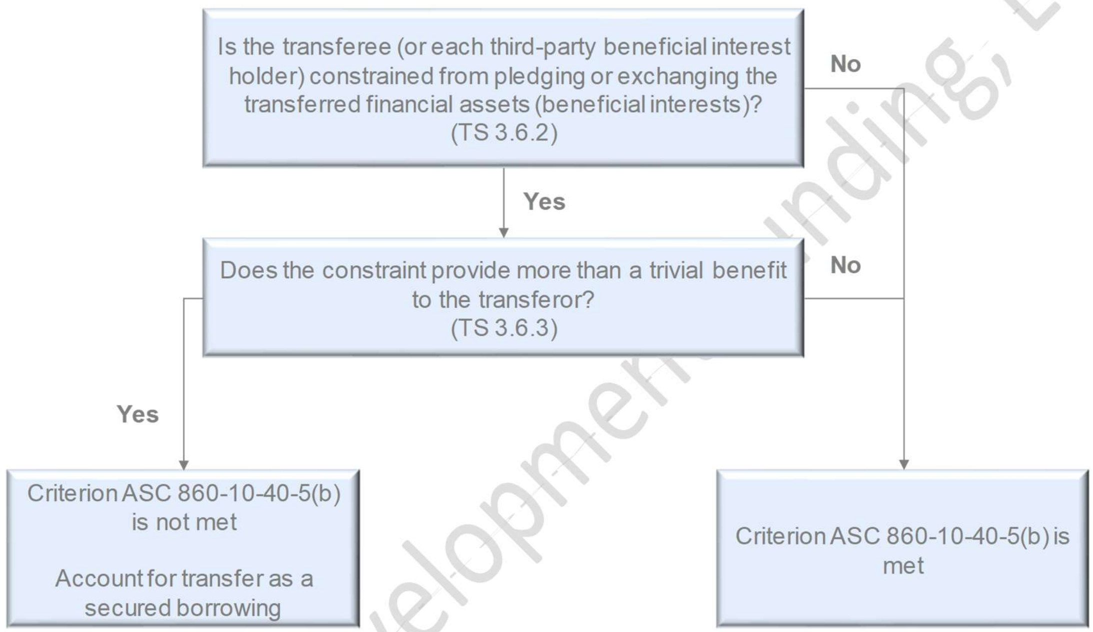
Legal isolation

Figure 3-2
Framework for Determining Evidence Required to Support Legal Isolation under ASC 860



Ability of transferee to pledge or exchange

Figure 3-3
Ability of Transferee to Pledge or Exchange Transferred Financial Assets



Servicing rights

4.2.5.1 Servicing Rights

A transferor may retain the contractual right to service transferred financial assets that have been derecognized. In that case, ASC 860-50-25 requires the transferor to recognize a separate servicing asset or servicing liability at the date of the exchange, measured at fair value. Thereafter, the recognized servicing asset or liability should be accounted for separately in accordance with eh guidance in ASC 860-50.

If a transfer involves a participating interest, ASC 860-50-25-1 clarifies that a recognized servicing asset or liability should relate only to the participating interest sold.

See TS 6 for information on accounting for servicing assets or servicing liabilities.