Off-Balance-Sheet Financing/Transaction

Off-balance sheet financing refer to the methods firms use to finance their operations and their investments in ways that allow them to record these transactions in subtle and obscure ways, or not at all. These transactions usually affect the balance sheet; and therefore, they are usually referred to as "off-balance sheet financing."

The most common forms of off-balance sheet financing are the following:

1) Off-Balance Sheet Entity
2) Operating Leases
3) Product-Financing Arrangements
4) Research and Development Financing Arrangements
5) Sale of Receivables with Recourse

We have write-ups on each of these methods. You should see those write-ups in the Glossary if you would like more detail on these methods.

Other Methods

However, there are many other methods that could be considered off-balance sheet financing. Furthermore, they are growing and changing all the time. Any agreement in which a firm acquires the use of some resource in exchange for financial commitments, or acquires cash in exchange for some resource constitutes an off-balance-sheet transaction. And it should be investigated.

Just some of the other more obscure off-balance-sheet financing techniques include:

6) Unconsolidated Finance Subsidiaries (similar to an off-balance sheet entity)
7) Collateralized Mortgage Obligations (CMO)
8) Collateralized Automobile Receivables (CAR)
9) Non-sub Sub
10) Non-sale Sale
11) Tax-Deductible Preferred

Fortunately, the counter to all these abuses is the same: read the footnotes. You should be able to discover the existence of these and most off-balance-sheet financing arrangements in the footnotes. Read especially closely the footnotes dealing with contingent liabilities and investments.

The last thing to keep in mind about off-balance sheet transactions is the following. All firms, on occasion, usually engage in at least a few of these techniques. But when a firm engages in a disproportionate number of them or engages in a few of them to a disproportionate degree, it may be an indication that that firm's true performance or financial position is not what it seems.