Product Financing Arrangements

Product Financing Arrangement is an off-balance sheet form of financing that is accomplished in one of two ways:

1) A sponsoring firm sells its inventory to another entity and simultaneously agrees to buy that inventory back at specified prices over a specified period of time.
2) Or, a sponsoring firm arranges for another entity (usually a trust created by the sponsoring firm) to purchase the inventory on the sponsoring firm's behalf, and the sponsoring firm simultaneously agrees to guarantee the entity's debt and to eventually purchase the inventory from the entity.

A sponsoring firm that engages in this practice can effectively obtain a cash loan without having to recognize it as a cash loan.

FASB is aware of this technique, and it has specified when product financing arrangements should be recognized as liabilities. However, unscrupulous firms do not always comply with these specifications and/or can find ways around them. Any product financing arrangement should be studied more closely.