

Accounting and Corporate Barter Trading



Accounting for Corporate Clients

How to account for corporate Barter (inc treatment of VAT)



An example:

Company A has £1,000,000 of inventory on its balance sheet. The inventory is excess/obsolete and has a net realisable value of £333,333. Company A writes down the asset and report a £666,667 loss in their P & L.

Alternatively;

Company A enters into a Barter Transaction with Astus UK Ltd. The inventory is sold to Astus UK for £1,000,000 plus VAT (if the inventory is subject to VAT). Company A raises an invoice for £1,000,000 plus VAT.

Company A issues an invoice for £1,000,000 plus VAT to Astus UK Limited.			
		£GBP	£GBP
Dr	Accounts receivable	1,200,000	
	Cr		Turnover
	Cr		Output VAT
			1,000,000
			200,000
Dr	Cost of Sales	1,000,000	
	Cr		Inventory
			1,000,000

Astus UK Ltd pays for the inventory with £1,000,000 Trade Credits. Astus UK raise an invoice to Company A for £1,000,000 Trade Credits plus VAT. This invoice is the pre-billing of future expenditure that company A will spend through the Astus UK process.

Astus UK Limited issues an invoice to Company A.			
		£GBP	£GBP
Dr	Prepaid expense *	1,000,000	
	Cr		Accounts payable
			1,200,000
Dr	Input VAT	200,000	

Following these entries the payable, receivable and VAT cancel each other out. It is advisable at this stage to contra the payable and receivable in order to avoid any confusion within Company A's accounting system. The inventory is removed and a pre-paid expense is created on the balance sheet. Provided the invoicing is done simultaneously in the same VAT period, there are no cash flow implications. (See Appendix 1, for notes on alternative VAT treatment)

* - What value should this asset rest on the balance sheet, see [Aggressive or conservative](#) later.

Subsequently Company A purchases £5,000,000 worth of television advertising from Astus UK. Company A pays for this with (as a generic example) £4,000,000 cash and £1,000,000 Trade Credits. Astus UK raises an invoice for £5,000,000.

Astus UK Limited issues an invoice to Co A for £5,000,000.			
		£GBP	£GBP
Dr	Advertising expense	5,000,000	
Dr	Input VAT	800,000	
	Cr	Accounts Payable	4,800,000
	Cr	Pre-paid expense	1,000,000

VAT is only charged on the cash payable of the invoice as the VAT on the Trade Credits has been accounted for through the initial invoice "swapping". This VAT treatment has been approved by HMRC.

Aggressive or conservative accounting?

An important consideration surrounding the transaction, although not affecting the overall profitability, is how to value the Trade Credits on the balance sheet. In the above example it is recommended to treat the Trade Credits as a pre-paid expense, but at what value?

An aggressive approach is to value the trade credits on a £ for £ basis. This records the benefit of the transaction on day one.

Alternatively, one can write down the value of the pre-paid expense to the net realisable value of the inventory that it has replaced, and accrue the benefit as the Trade Credits are utilised. In this case the accounting above changes as follows;

After receiving the initial invoice from Astus UK Ltd, Company A writes down the value of the trade credits to the initial NRV of the inventory			
		£GBP	£GBP
Dr	Asset w/down expense account	666,667	
	Cr	Pre-paid expense	666,667

Astus UK Limited issues an invoice to Co A for £5,000,000.			
		£GBP	£GBP
Dr	Advertising expense	5,000,000	
Dr	Input VAT	800,000	
	Cr	Accounts Payable	4,800,000
	Cr	Pre-paid expense	333,333
	Cr	Asset w/down expense account	666,667

The barter transaction is a non-monetary transaction and the accounting follows UK GAAP guidance on non-monetary transactions. Revenue recognition is based on the fair values of the two non-monetary assets. In most instances the fair value of the non-monetary asset given up is more clearly evident than the fair value of the trade credits received and therefore should be the basis for recording the transaction. However this is not necessarily true where the value of the Trade Credits can be measured either by historical trends or clear future planned usage.

In November 2000 the UK UITF released abstract 26 ([see appendix 2](#)) to deal specifically with “Barter transactions for advertising”. The abstract deals with the accounting for transactions where advertising services are provided in exchange for advertising. The abstract prohibits the recognition of turnover and costs in respect of a barter transaction for advertising unless there is persuasive evidence of the value at which, if the advertising had not been exchanged, it would have been sold for cash in a similar transaction. The abstract is not mandatory for barter transactions for services other than advertising, but its principles may be relevant.

If one applies these principles to a corporate barter transaction then the carrying value of the Trade Credits received will equal the cash that a company could have received. In other words, the trade credits have a carrying value equal to the net realisable value of the asset sold for trade credits.

As illustrated by the bookkeeping above, the appropriate accounting merely impacts the timing of recording the economic benefit of the Trade Credits. After they have been utilised, the bookkeeping ends up with the same positive impact on profitability as the economic benefit.

Since the variables to a barter transaction are often different, and each country’s accounting principles and practices may and do vary from those of another, the analysis and accounting of each transaction should be reviewed by each company’s financial department, and where necessary, with its external accountants.

Important - Alternative VAT treatment

Recently HMRC allowed a different approach to the “Invoice swapping” discussed earlier. In essence they confirmed that the Barter Company need not issue an invoice for the Trade Credits. Instead the VAT is accounted as and when the Trade Credits are utilised. It is easy to see why HMRC would come to this conclusion as total taxes paid over are the same whether invoices are swapped or not.

However, at Astus UK, we believe it is important to clearly illustrate the negative cash flow impact on a client if this approach is adopted.

In the earlier example, £1,000,000 Trade Credits are issued. In the new scenario no invoice is raised by Astus UK, who issue £1,200,000 Trade Credits (£1,000,000 plus 20% VAT). Astus UK recovers the input VAT but do not pass this on to the client, instead issuing a further £200,000 Trade Credits. Provided these Trade Credits are utilised in full there is no negative profit impact, but the added CASH investment into the transaction may not always be clear, and there is certainly a negative cash flow impact at the beginning of the transaction.

In the earlier example, Company A forgoes recovering £333,333 cash (“Investment”) for their distressed inventory and enters into a transaction for £1,000,000 Trade Credits. If Trade Credits are issued to cover the gross value of the inventory, a further £200,000 cash is invested into the transaction for a further £200,000 Trade Credits

Comparison of cash risk with two different VAT treatments:

	£GBP	£GBP
Inventory Proceeds	333,333	333,333
VAT	-	200,000
Risk to client	333,333	533,333
Trade credit issued	1,000,000	1,200,000

At Astus UK we believe either method can be viewed as best practice but in all cases the client should be fully aware of what resources they are committing and be clear of the implications of different VAT accounting.



ACCOUNTING
STANDARDS
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Appendix 2.

URGENT ISSUES TASK FORCE

INFORMATION SHEET No 43

9 November 2000

This Information Sheet

- reports the issue of UITF Abstract 26 'Barter transactions for advertising'
- reminds readers of the implications of UITF Abstracts for smaller entities that elect to apply the FRSSE.

Abstract 26 'Barter transactions for advertising'

The above Abstract is issued today. It deals with the accounting for transactions where advertising services are provided in exchange for advertising, for example where Internet companies exchange advertisements on each others' Websites. It is based on the draft that was included in UITF Information Sheet 40 (July 2000), the proposals of which were supported by most of those who responded.

The Abstract prohibits the recognition of turnover and costs in respect of barter transactions for advertising unless there is persuasive evidence of the value at which, if the advertising had not been exchanged, it would have been sold for cash in a similar transaction. In these circumstances, that value should be included in turnover and costs. The Abstract states that persuasive evidence of the value of advertising exchanged will exist only where the entity has a history of selling similar advertising for cash, and where substantially all of the turnover from advertising within the accounting period is represented by cash sales. Factors that need to be considered in judging the evidence of the value of exchanged advertising are set out in the Abstract.

The Abstract applies to all transactions that are in substance barter transactions for advertising. A distinctive feature of such transactions is that they involve little or no marginal cost. Whilst the Abstract is not mandatory for barter transactions for services other than advertising, it notes that its principles may be relevant for such transactions.

Abstract 26 is effective for financial statements relating to accounting periods ending on or after 23 December 2000.

UITF Abstracts and the FRSSE

Every UITF Abstract includes a paragraph to the effect that reporting entities electing to apply the Financial Reporting Standard for Smaller Entities (FRSSE) are exempt from the Abstract. This reflects the ASB’s policy of including all requirements that apply to such entities in a single standard, the FRSSE. The FRSSE is updated as necessary, and each review considers whether it is desirable for the FRSSE to incorporate the requirements of recent Abstracts.

The exemption for smaller entities using the FRSSE does not therefore imply that the requirements of an Abstract are inappropriate for such entities. As noted in the FRSSE,

“Financial statements will generally be prepared using accepted practice and, accordingly, for transactions or events not dealt with in the FRSSE, smaller entities should have regard to other accounting standards and UITF Abstracts, not as mandatory documents, but as a means of establishing current practice.”

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