CREATING VALUE THROUGH CORPORATE TRADE UNDER IFRS

The concept that business strategies should be judged by the economic value they create is commonly accepted in the business community. Companies often, in the ordinary course of business, produce some amount of excess inventory, capital goods or real estate as technology advances, supply outpaces demand or changes in the business environment occur. These excesses, overstocks or underutilized assets are also referred to as "underperforming assets" and represent a substantial corporate value opportunity that is often times suboptimized. Corporate trade is a strategy to create value typically in the form of cash savings or incremental business. Amazingly, while corporate trade creates substantial economic benefits, it is often misunderstood and consequently overlooked.

In evaluating the productivity of assets, some companies may dispose of their underperforming assets through liquidation and realize 30-40% of the assets' original value, while other companies today are utilizing corporate trade strategy to realize a much greater economic value of the assets traded. The potential realization of an extra 60%-70% of value is substantial.

How Does Corporate Trade Work?

A corporate trade strategy involves selling the assets at typically 2-3 times greater than their current fair market value to a corporate trading company such as Active International ("Active"). Active purchases these assets using its currency known as trade credits. Trade credits coupled with cash (rather than 100% cash) are then used by the selling company to purchase media, retail marketing, printing, travel or other goods and services through Active at the equivalent independently determined cash amounts that would have otherwise been spent. Thus, corporate trade creates value through cash savings. Certain companies have also applied a similar strategy utilizing excess manufacturing capacity to produce products for corporate trade which can be distributed outside their normal distribution channels. This corporate trade strategy creates incremental business and, at the same time, creates economic benefit as the trade credits are utilized.

In the case of media, Active operates in the same capacity as the media-buying department of an advertising agency. The price of the media or other goods and services purchased through Active is benchmarked or matched to what the selling company would have paid, except that when such services are purchased through Active, the services are paid for with a combination of cash and trade credits at prices established by the selling company and its suppliers. Thus, the utilization of the trade credit creates cash savings and real economic value from amounts that would otherwise have been spent. No media or other service order is ever placed without the selling company and its advertising agency's approval (in the case of advertising) and, as a result, the services purchased meet all of the selling company's specifications.

Active charges no fees or commissions and, in the case of media, Active bills the media net of an advertising agency standard commission up to 15% so as not to interfere with the selling company/advertising agency relationship. Further, Active provides full proof of performance so the selling company can easily ascertain that what was ordered was, in fact, delivered. With respect to non-media goods and services, the process works similarly.

Accounting and Financial Statement Treatment

Authoritative accounting guidance for corporate trading or barter for is generally set forth in International Financial Reporting Standards (IAS16, IAS18, IAS38, IAS40, IFRIC18 and SIC-31).

Under IAS18 12, "When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair market value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair market value of the goods or services received cannot be measured reliably, the revenue is measured at the fair market value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred." In a corporate trade transaction, since services associated with a trade credit have not yet been rendered utilizing the trade credits exchanged, revenue is not recognized and such amount is reflected as a prepaid asset.

Thus, corporate trade transactions under IFRS involving exchanges of assets for a trade credit have commercial substance and are generally measured at the fair market value of assets exchanged unless the fair market value of the trade credit is more clearly evident. Fair market value is "the amount for which an asset could be exchanged or liability settled between knowledgeable, willing parties in an arm's length transaction." IFRS13 similarly defines fair market value as "the

price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

To properly account for a corporate trade transaction involving the exchange of an asset for trade credits, the entity would measure the transaction at fair market value. Since the asset traded for the corporate trading company's trade credit provides an economic opportunity for the company to realize increased economic value in the form of cash savings as the trade credit is used, commercial substance exists. Accordingly, the trade credits received are reflected at the fair market value of the traded asset as a prepaid marketing asset as the consideration given up by the seller (the asset traded) may be more reliably measured. The prepaid marketing amount would be amortized as the trade credit is used. Alternatively, if the fair market value of the trade credits received can be more reliably measured, meaning their value is assured, then under IFRS, a gain would be recognized assuming the trade credit fair market value was greater than the fair market value of the asset exchanged and related carrying amount.

Under accounting standards generally accepted in the United States, Financial Accounting Standards Board, Accounting Standards Codification Topic 845 specifically provides that, in reporting the exchange of a non-monetary asset for barter or trade credits, it is presumed that the fair market value of the non-monetary asset exchanged (receivables, inventory, capital equipment, real estate or leases) is more clearly evident than the fair market value of the barter or trade credits received, unless the entity can demonstrate that there is a history of converting barter credits into cash after receipt, in which case, the transaction would be measured at the fair market value of the trade credits received.

The barter or trade credits should generally be reported at the fair market value of the asset exchanged. It should also be presumed that the fair market value of the non-monetary asset does not exceed its carrying amount unless there is persuasive evidence supporting the higher value and utilization of the trade credit.

Generally, until used, the barter or trade credits are carried as a prepaid expense on the company's balance sheet. In effect, until the trade credit is used, the traded asset is reclassified from inventory to prepaid expense at its fair market value, up to its historical carrying value, after determining the reasonable assurance level of whether the trade credits will be utilized.

Any impairment on the barter or trade credits should be recognized if (1) it subsequently becomes apparent that the fair market value of any remaining trade credits is less than the carrying amount or (2) it is probable that the enterprise will not use all of the remaining barter credits.
Since the determination of fair market value may, depending on the nature of the assets to be traded, be somewhat subjective in nature in assessing fair market values, the accounting treatment of a corporate trading transaction may vary. Accordingly, interested parties should consult with their respective accounting advisors to determine the appropriateness of the suggested accounting treatment. The example which follows illustrates a typical arrangement relative to the points described above. Other structures and arrangements may exist in practice which the trading company could design to meet a specific client's objective.

Examples, Facts and Assumptions

Assume that a company sells an underperforming asset to the trading company with a carrying or book value of €1,000,000 and a market value of €300,000 for €1,000,000 in trade credits which are used over three years (assumed contract term) at an 80:20 (cash:trade credit) ratio or blend. In this case, €5,000,000 of cumulative purchases of media, travel, printing or other goods and services would fully utilize the trade credits.

Further assume that the company has annual media expenditures totaling over €10,000,000 and, for simplicity purposes, the trade credits are utilized equally over the three years against future media purchases.

From the seller company's perspective, the benefits of the transaction are to create value through cash savings that otherwise would be lost if an immediate liquidation strategy was followed for this asset. As noted below, €700,000 of net economic value is created.

The Economic Benefits of the Transaction
(Figure 1)

Cost of Goods and Other Services Acquired at Benchmark Prices	€	5,000,000
Consideration Given Up for Goods and Other Services Acquired:		
Cash Component	€	4,000,000
Fair Market Value of Inventory		300,000
Total Consideration		4,300,000
Value and Cash Savings Created	€	700,000

Under IFRS, the asset traded is generally reflected prior to the exchange at the lower of cost or net realizable value (for inventories) or fair market value (other assets) and the economic benefit of the trade credit will be realized as the trade credit is utilized. Accordingly, a prepaid expense would be recognized at the outset of the transaction at the fair market value of the asset exchanged. If this asset was carried at a value greater than fair market value, then the asset would be written down to fair market value.

Situation # 1

Assuming the company has no experience with trade credits and the inventory in question would be adjusted to its net realizable value of €300,000. Inventory would be sold to the corporate trade company for €1,000,000 in trade credits and a prepaid expense for €300,000 would be reflected by the selling company. The financial impact of these assumptions is summarized below.

Financial Impact of Trade (In €1,000s)
(Figure 2)

	At Contract signing Date	Year 1	Year 2	Year 3	Cumulative Totals
Cash Outlay	N/A	€1,333	€1,333	€1,334	€4,000

	At Contract signing Date	Year 1	Year 2	Year 3	Cumulative Totals
Prepaid Expense Amortization Change	N/A	€100	€100	€100	€300
Balance Sheet Prepaid Expense Account	€300	€200	€100	N/A	N/A

Situation # 2

If trade credit utilization were assured, the accounting for the non-monetary transaction would be different than as summarized above.

At the outset of the transaction, the company would recognize a prepaid marketing asset in the amount of €1,000,000 and relieve its inventory account by a like amount as trade credit utilization is assured and the economic benefit of the trade credits received is more reliably measured (assuming lower of cost or market for inventory was €1,000,000). Effectively, the company has exchanged its underperforming asset to pay for future media. If the asset, on the other hand, was carried at a fair market value of €300,000 prior to the corporate trade transaction, then on the exchange the company would recognize a gain of €700,000 assuming trade credit utilization was assured. The figure below summarizes the financial aspect of the corporate trade transaction over a three-year contract period.

Financial Impact of Trade (In $1,000s)
(Figure 3)

	At Contract signing Date	Year 1	Year 2	Year 3	Cumulative Totals
Cash Outlay	N/A	€1,333	€1,333	€1,334	€4,000
Prepaid Expense Amortization Change	N/A	€333	€333	€334	€1,000
Balance Sheet Prepaid Expense Account	€1,000	€667	€334	N/A	N/A

As noted above, any subsequent impairment of the barter or trade credits should be recognized if it subsequently becomes apparent that the entity will probably not use the remaining trade credits and that the related fair market value is less than the carrying value.

Intracompany Trade Credit Utilization

Some companies reflect the acquisition of trade credits (prepaid marketing) as a corporate asset. As the trade credits are utilized by other operating divisions, the marketing expense incurred by those divisions may be at the amount that would otherwise have been incurred on a 100% cash basis, i.e., the benefit of the utilization of the trade credit is reflected at the corporate level, not at the operating level. In this manner, control over operating budgets may be maintained, but the operating unit may not be sufficiently motivated to utilize the trade credit as it does not realize any trade credit utilization benefit.

Accordingly, to properly motivate those divisions who may positively accelerate trade credit utilization as well as realize the full value of the trade credits, the trade credits' economic benefit should be shared with the operating division which utilizes the trade credits. Planned expenditures, as documented in corporate and operating divisional budgets, should reflect the planned utilization of trade credits in order to maintain budgetary control over the related expenditures and trade credits to be utilized. In this manner, when actual expenditures are compared to planned expenditures, the operating unit realizes a portion of the economic benefit of the trade credits as the trade credits are utilized, while at the same time, budgetary control over the related expenditures is maintained and the operating unit is appropriately motivated.

Conclusion

Corporate trading creates value and is easily applied. This financial strategy will recover substantially greater economic benefit of excess or underperforming assets rather than the 30%-40% typically achieved through liquidation. Key considerations at the outset of a transaction are:

- Can trade credits be used easily?
- Are you satisfied with the scale and depth of services of the trading company and does the trading company have a successful track record of retiring trade credits for clients?
- Is proof-of-performance accompanied by affidavits and post-buy analysis in the case of media routinely provided?
- Does the trading company possess the ability to provide complete, professional, in-house media staff with agency-trained buyers who have sufficient experience?
- Are the purchases of goods and services at the same quality and at the same price that would otherwise be purchased?
- Are sufficient and appropriate fulfillment inventories or capacities maintained to satisfy anticipated client needs?
- Does the trading company maintain a demonstrated ability to re-market merchandise, real estate and capital goods to specified end-users exist?

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