UITF abstract 32
Employee benefit trusts and other intermediate payment arrangements

(Issued 13 December 2001)

Scope

This Abstract deals with intermediate payment arrangements as described in paragraphs 2-3 below. Although employee share ownership plans (ESOPs) are an example of intermediate payment arrangements, this Abstract does not apply to them because there is already a UITF Abstract on the subject (UITF Abstract 13 'Accounting for ESOP Trusts'). Similarly, pension funds, another example of intermediate payment arrangements, are not dealt with in this Abstract because they are the subject of an accounting standard (FRS 17 'Retirement Benefits'). 1

Background

In a typical employee benefit trust, an entity makes payments to a trust, the beneficiaries of which are to be the entity's employees, and the trust then uses assets accumulated from those payments to pay the entity's employees for some or all of the employee services they have rendered to the entity. 2

The arrangement described in paragraph 2 is only one example of an 'intermediate payment arrangement'. Such arrangements may take a variety of forms. 3

(a) Although the intermediary is usually constituted as a trust, other arrangements are possible.

(b) Although such arrangements are most commonly used to pay employees, they are sometimes used to compensate suppliers of goods and services other than employee services. Sometimes the sponsoring entity's employees and other suppliers are not the only beneficiaries of the arrangement. Other beneficiaries may include past employees and their dependants, and the intermediary may be entitled to make charitable donations.

(c) Usually, the precise identity of the persons or entities that will receive payments from the intermediary, and the amounts that they will receive, are not agreed at the outset.

(d) The relationship between the sponsoring entity and the intermediary may take different forms. For example, when the intermediary is constituted as a trust, the sponsoring entity will not have a right to direct the intermediary's activities. However, in these and other cases the sponsoring entity may give advice to the intermediary or may be relied on by the intermediary to provide the information it needs to carry out its activities. Sometimes, the way the intermediary has been set up gives it little discretion in the broad nature of its activities.

(e) Often, the sponsoring entity has the right to appoint or veto the appointment of the intermediary's trustees (or its directors or the equivalent).

(f) The payments made to the intermediary and the payments made by the intermediary are often cash payments but may involve other transfers of value.

The issues

4 This Abstract addresses two accounting issues that arise when intermediate payment arrangements are entered into:

(a) whether the sponsoring entity's payments to the intermediary represent an immediate expense of the entity; and

(b) if the payments do not represent an immediate expense, what is the nature and extent of the sponsoring entity's assets and liabilities after making the payment to the intermediary.

Does the sponsoring entity's payment to the intermediary represent an immediate expense?

5 Generally speaking, most expenses are incurred not when they are paid for but when a liability arises. For example, when an entity receives cleaning services the expense arises as it receives those services not when it pays for them, regardless of whether the services are paid for before they are received or after they have been received.

6 That is also the case for goods and services (including employee services) paid for through an intermediate payment arrangement. For example, with an employee benefit trust, generally speaking:

(a) the expense will be incurred when a liability for the employee costs arises. This will only coincidentally be when payment is made to the intermediary;

(b) the payment made by the intermediary will either settle a liability or will be made in advance of the liability arising (ie it will be a prepayment); and

(c) the payment made to the intermediary will involve the exchange of one asset for another.

A payment made to an intermediary will represent an immediate expense of the sponsoring entity only if the payment neither results in the acquisition of another asset (for example, restricted cash or a prepayment) nor settles a liability. Whether a payment involves the full or partial settlement of a liability is a matter of fact and is not considered in this Abstract. The Abstract focuses instead on whether the payment involves the acquisition of another asset. 7

An asset is defined in the Statement of Principles for Financial Reporting as a right or other access to future economic benefits that is controlled by the entity as a result of a past transaction or event. The attributes of an asset are therefore the access to future economic benefits and the control of that access. 8

(a) Future economic benefit can be obtained in a variety of forms. In the context of intermediate payment arrangements, probably the most common form the benefit takes is meeting some or all of the cost of goods or services provided to the sponsoring entity. That benefit can be the basis for an asset even though it is not capable of being turned into cash or of being distributed in a liquidation.

(b) Control comprises two abilities, the ability to direct and the ability to benefit from that direction. Although control is probably most visible when it is exerted through intervention and instruction on an ongoing day-to-day basis, it can be present in a variety of other guises. For example, even though a sponsoring entity of an intermediate payment arrangement involving a trust does not have the right to dictate to trustees how they should exercise their responsibilities under a trust, it may still, as Abstract 13 makes clear, have de facto control of that trust's assets and liabilities. Although Abstract 13 focuses on ESOP trusts, it is based upon the wider principles of FRS 5 'Reporting the Substance of Transactions' and its analysis, explanations and conclusions are relevant in analogous circumstances such as when other intermediate payment arrangements are involved.

FRS 5 requires that, when determining whether an entity has an asset, one should look beyond the structure of the transaction to consider its substance; in other words, consideration should be given to the commercial effect of the transaction in practice. Recognising that it is highly unusual for an entity to pay a significant amount to a third party without receiving something in return, the UITF takes the view that, when an entity transfers funds to an intermediary, there should be a rebuttable presumption that the sponsoring entity will obtain future economic benefit from the amounts transferred and that it has control of the rights or other access to those future economic benefits. 9

To rebut this presumption at the time the payment is made to the intermediary, it will be necessary to demonstrate that either: 10

(a) the sponsoring entity will not obtain future economic benefit from the amounts transferred. For example, it may be that the only beneficiaries of the intermediary are registered charities or a benevolent fund that is in no way linked to amounts otherwise due from the entity; or

(b) the sponsoring entity does not have control of the rights or other access to the future economic benefits it is expected to receive. This will involve evidence that the payments made by the intermediary are not habitually made in a way that is in accordance with the sponsoring entity's wishes.

11 The presumption of future economic benefit would not be rebutted where payments by the intermediary served to relieve the sponsoring entity from paying for such items as retirement benefit increases or benefits in kind (for example, medical insurance cover).

12 The presumption of control would be rebutted at the time the payment is made to the intermediary if at that time the asset(s) transferred to the intermediary vest unconditionally in identified beneficiaries.

13 If, and to the extent that, the sponsoring entity has obtained rights or other access to future economic benefit over which it has control through its payment to the intermediary, the payment will involve an exchange of one asset for another and no immediate expense will be incurred.

If the sponsoring entity's payment to the intermediary does not represent an immediate expense, what is the nature and extent of its assets and liabilities after the payment?

14 As explained above, if a payment made by a sponsoring entity to an intermediary involves an exchange of one asset for another, that will be because, despite paying money to the intermediary, the sponsoring entity continues to have the benefit of that money and to have control of that benefit; in other words, the amount paid to the intermediary remains an asset of the sponsoring entity despite being in the intermediary's possession. That will remain the case if the intermediary then exchanges some or all of that amount for other assets. The UITF takes the view that, in such circumstances, the sponsoring entity has de facto control of the intermediary's assets and should, as a result, account for the intermediary as an extension of its own business. The intermediary's assets, and any liabilities that it has, should therefore be recognised as assets and liabilities of the sponsoring entity. The subsequent accounting for those assets and liabilities and for expense recognition should follow the normal accounting rules. Accordingly, an asset held by the intermediary would cease to be recognised as an asset of the sponsoring entity when, for example, it vests unconditionally in identified beneficiaries.

15 Abstract 13 concludes that the assets and liabilities of most ESOP trusts are under the de facto control of the sponsoring company. The UITF is of the view that the reasoning that leads to that conclusion—and the conclusion itself—applies equally to the assets and liabilities of most employee benefit trusts.

Application to smaller entities

Reporting entities applying the Financial Reporting Standard for Smaller Entities currently applicable are exempt from this Abstract. 16

UITF consensus

This UITF consensus applies to all intermediate payment arrangements other than those dealt with in Abstract 13 or FRS 17. 17

The UITF reached a consensus that, when an entity transfers funds to an intermediary, there should be a rebuttable presumption that the sponsoring entity has exchanged one asset for another and that the payment itself does not represent an immediate expense. 18

Where a payment to an intermediary is an exchange by the sponsoring entity of one asset for another, any assets that the intermediary acquires in a subsequent exchange transaction will also be under the de facto control of the sponsoring entity. The intermediary's assets, and any liabilities that it has, should therefore be recognised as assets and liabilities of the sponsoring entity. The subsequent accounting for those assets and liabilities and for expense recognition should follow the normal accounting rules. Accordingly, an asset held by the intermediary would cease to be recognised as an asset of the sponsoring entity when, for example, it vests unconditionally in identified beneficiaries. 19

When an entity recognises the assets and liabilities held by an intermediary on its balance sheet, it should disclose sufficient information in the notes to its financial statements to enable readers to understand any restrictions relating to those assets and liabilities. 20

Date from which effective

The accounting treatment required by this Abstract should be adopted in financial statements relating to accounting periods ending on or after 23 December 2001, but earlier adoption is encouraged. Where applicable, corresponding amounts should be restated. 21

References

ASB pronouncements

Statement of Principles for Financial Reporting, paragraphs 4.6 and 4.39
FRS 5 'Reporting the Substance of Transactions', paragraphs 14, 16, 20 and 54
FRS 17 'Retirement Benefits'
UITF Abstract 13 'Accounting for ESOP Trusts', paragraph 2(d) and the appendix