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Letter of Comment No: 9  
File Reference: 1200-300  
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MP&T Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

**Re: Proposed Statement of Financial Standards – Exchanges of Productive Assets – an amendment of APB Opinion No. 29 (File Reference 1200-300)**

I appreciate the opportunity to comment on the above-captioned exposure draft. My concerns involve the following issues:

**1. The exchange of productive assets between related parties.**

In the very first example in the exposure draft, where Company A exchanged its warehouse in Ohio for Company B's warehouse in California, assuming commercial substance, would Company A recognize a \$2 million gain on the warehouse in Ohio and record the warehouse in California at its fair value, when Company B is owned or controlled by –

- (a) An officer of Company A?
- (b) An independent director of Company A?

**2. Commercial substance.**

I am intrigued by the “notion of commercial substance,” and “commercial substantive exchange” which to the best of my knowledge has not been previously defined in the accounting literature.

Defining “commercial substance” as estimated future cash flows underlying the asset received versus the asset delivered is, to many accountants, a “crystal ball” exercise facilitated by Excel spreadsheets. The permutations of variables used in the computation of these two separate cash flows produces results that may be virtually unverifiable by an independent auditor. Is management's best guess as to expected

cash flows (of a property they do not yet own) good enough to record an accounting gain?

What is missing from this spreadsheet exercise is a solid foundation for determining such cash flows. Are they cash flows that relate to, using the Boards example, all inflows from both warehouses less all outflows directly related to the warehouses, including the tax cash flows relating to any excess? And if the cash flows from the warehouse received are greater than the cash flows of the warehouse given up (say for example by a small margin - \$1) then a gain may be recorded, or is the gain limited to no more than the difference in the weighted average discounted after-tax cash flows?

In addition, that "commercial substance" may be the entity specific value of that part of the reporting company's operations impacted by the transaction both before and after the exchange I believe is equally subject to management's best guess. Again, is this good enough to record a financial statement gain?

Equally interesting is the idea that economics is not necessarily a zero sum game. Ordinarily meaning that in a two party game, one player's winnings equals the other player's losses. However, this ED seems to allow each party to predict excess cash flows based upon the exogenous benefits to the company from its sole use of the warehouse. Can both parties, in the example (Company A and Company B) have positive cash flows after the exchange in excess of those they had before the exchange? Very likely. Assuming Company B's warehouse has a carrying amount and fair value equal to Company A, this allows both parties to book a \$2 million gain.

If B's fair value of its warehouse was less than \$3 million Co A still records a \$2 million gain, notwithstanding the FV of its new warehouse is less than \$3 million.

In general, recording gains (possibly on both sides of the transaction) seems imprudent, and it may be time to let the IASB go its own way on this issue. "Commercial substance" needs a much better and tighter definition -- this will be another auditor's nightmare -- and a litigating attorney's dream.

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I will be pleased to discuss these comments or answer any questions that you may have. Please contact me at 212-468-7820.

Sincerely,

Robert N. Waxman, CPA