

April 16, 2004

Letter of Comment No: 26  
File Reference: 1200-300  
Date Received: 4/16/04

Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

**File Reference No. 1200-300 - Proposed Statement of Financial Accounting Standards,  
Exchanges of Productive Assets, an amendment of APB Opinion No. 29**

Dear Ms. Bielstein:

We are pleased to offer comments on the Proposed Statement of Financial Accounting Standards, *Exchanges of Productive Assets, an amendment of APB Opinion No.29* (the Exposure Draft or proposed Statement). We support the Board's efforts to promote international convergence by removing individual differences between U.S. GAAP and International Financial Reporting Standards ("IFRS"). We encourage the Board to continue to work closely with the International Accounting Standards Board and other national standard setters to develop high-quality standards that will be applied globally. In general, we support the overarching idea of fair value accounting for nonmonetary transactions and, thus, support issuance of a final standard with this underlying principle. However, we believe there are several matters that require clarification or reconsideration to make the proposed Statement effective. Our specific comments on the Exposure Draft are discussed below.

***Interaction with the Revenue Recognition Project***

We note that the issues addressed in this proposed Statement overlap with the Board's project on revenue recognition. Currently, APB Opinion No. 29, *Accounting for Nonmonetary Transactions* (APB 29), addresses revenue (or gain) recognition and measurement in paragraph 21, which states, in part:

If the exchange is not essentially the *culmination of an earnings process*, accounting for an exchange of a nonmonetary asset between an enterprise and another entity should be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) of the nonmonetary asset relinquished... (Emphasis added)

This paragraph in APB 29 continues by describing two types of nonmonetary exchange transactions that do not culminate an earnings process. These transactions are basically an exchange of an asset for a similar asset. Other than the description of exchanges of similar assets and reference to the culmination of an earnings process, APB 29 does not provide guidance regarding revenue or gain recognition. In practice, we believe that entities have generally also looked to the guidance regarding revenue or gain recognition applicable to the transferred asset in a monetary transaction to determine whether there has been a culmination of the earnings process and revenue or gain recognition is appropriate. This additional guidance may be based on a risks and rewards approach or a control-

based approach. This additional guidance may permit revenue or gain recognition for a monetary transaction even though the transferor has continuing involvement with the transferred asset (e.g., warranties, put rights, etc.).

The Board proposes adding a condition to the definition of an exchange in paragraph 3(c) of APB 29 that “a non-monetary asset is not considered an exchange unless the transferor has *no continuing involvement* in the transferred asset such that all the *risks and rewards of ownership* of the asset are transferred (Emphasis added).” In addition, paragraph A6 of the Exposure Draft provides the Board’s basis for the proposed change and states, in part:

The Board noted that certain transactions that appear to be nonmonetary exchanges are in fact not exchanges at all because the transferor does not *relinquish control* of a transferred asset such that derecognition is appropriate. The Board did not want this Statement to establish a less restrictive standard for gain recognition than the standard for gain recognition that is applicable to transactions involving monetary consideration. Therefore, the Board decided that a transfer of a nonmonetary asset is not considered an exchange for the purposes of this Statement unless the transferor has no continuing involvement. (Emphasis added)

It appears that the Board is introducing revenue recognition guidance in the proposed Statement that is more restrictive than current guidance for similar monetary transactions. For instance, the proposed guidance appears to require both a risks and rewards approach (paragraph 2 of the proposed Statement) and a control approach (paragraph A6 of the proposed Statement) when current revenue or gain recognition guidance for monetary transactions is usually based on a risks and rewards approach or control approach, but not both. In addition, the proposed guidance would prohibit derecognition of the asset transferred if the transferor has any continuing involvement with the transferred asset while current revenue (or gain) and asset derecognition guidance often permits certain types of continuing involvement.

We believe that a final Standard should not create new revenue recognition guidance for nonmonetary transactions until the Board has completed its project on revenue recognition. Thus, we do not support the proposed addition to the definition of an exchange in paragraph 3(c) of APB 29. Instead, we believe that the proposed Statement should indicate that a transferred asset should not be derecognized and revenue or gain should not be recognized unless the conditions for derecognition and revenue or gain recognition in other accounting standards applicable to the transfer of the asset in a monetary transaction have been met.

### ***Commercial Substance***

In determining whether certain nonmonetary transactions should be accounted for at fair value, the Exposure Draft indicates that exchanges that lack “commercial substance” should be reflected at the recorded amount of the asset relinquished. We agree with the principle that transactions that lack substance should not be afforded income recognition. The Exposure Draft also provides conditions that must be met in order to determine whether an exchange has commercial substance. That is, an exchange has commercial substance if neither of the following differences is significant relative to the fair value of the assets exchanged:

- a) The configuration (risk, timing, or amount) of the expected future cash flows of the asset received as compared to the configuration of expected cash flows of the asset transferred (evaluation (a)), or

- b) The entity-specific value of the entity's operations prior to the exchange as compared to the entity-specific value after the exchange (evaluation (b)).

We are concerned about whether the conditions for determining commercial substance are operational and will provide results consistent with the Board's intention. For example, we are unsure how to quantify the risk in the cash flows (evaluation (a) above) in order to be compared to the fair value of the assets exchanged. We are also unsure how to relate the "configuration" of cash flows to the fair value of the assets exchanged in order to determine if the transaction has commercial substance. In addition, we expect that there will be many situations in which it will be difficult to discern the expected future cash flows of the assets exchanged. For example, assume a company trades a desk for a needed printer; an exchange that we believe meets the underlying principle of having substance. Both are used by the company in helping employees perform their functions but neither is readily viewed as generating future cash flows. We are not exactly sure how to perform the quantitative analysis called for by evaluation (a) for determining whether the exchange has commercial substance. In addition, as the second evaluation (evaluation (b)) is also based on cash flows, we are not sure that this analysis will be operational either. We do not believe that determining whether an exchange of assets is substantive, the underlying principle, should rely solely on cash flow tests.

If the Board decides to retain the steps to determine commercial substance as proposed in the Exposure Draft, we believe there is still a significant difference between the guidance in the Exposure Draft and IFRS. IAS No. 16, *Property Plant and Equipment*, also provides similar steps for determining if an exchange has commercial substance in paragraph 34A. However, this paragraph also states, "The result of these analyses may be clear without an entity having to perform detailed calculations." In order to fully converge, we believe that an amendment of APB 29 should contain the same language.

#### **Scope of APB 29**

We agree with the continued application of APB 29 to non-monetary exchanges of real estate as proposed in the Exposure Draft. In addition, we agree with the proposed amendments in the Exposure Draft that all exchanges involving the transfer of a nonmonetary financial asset within the scope of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, such as equity method investments should not be within the scope of APB 29. We also agree with excluding from APB 29 transactions described in paragraph 44(a) of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*.

#### **Other Comments**

We agree with the proposed amendments to the EITF Issues in Appendix B. However, we believe the following issues should also be evaluated and the status section updated for the issuance of a final Standard amending APB 29:

EITF 91-5, *Non-monetary Exchange of Cost Method Investments*

EITF 93-11, *Accounting for Barter Transactions Involving Barter Credits*

EITF 99-17, *Accounting for Advertising Barter Transactions*

EITF 01-2, *Interpretations of APB Opinion No. 29 Issue 8(a)*, (i.e., if substantive nonmonetary transactions where fair value is determinable will be recorded at fair value, is it necessary to determine whether the transactions is monetary or nonmonetary based on the amount of "boot" involved?)

EITF 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*

EITF 03-11, *Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133 and Not "Held for Trading Purposes" as defined in Issue No. 02-3*

\*\*\*\*\*

We appreciate your consideration of our comments. Should you have any questions regarding our response, please contact James Johnson at (203) 761-3709 or Robert Uhl at (203) 761-3705.

Yours Truly,

Deloitte & Touche LLP