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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
File Reference 1200-300
Financial Accounting Standards Board
401 Merritt 7
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Letter of Comment No: 16
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Dear Ms. Bielstein:

BDO Seidman, LLP is pleased to offer comments on the Proposed FASB Statement, *Exchanges of Productive Assets.*

We recommend that the FASB not issue the Proposed Statement. In our opinion, the Proposed Statement is inferior to APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* and is, therefore, contrary to the stated objective of harmonizing with the IASB with standards that are equivalent, or superior, to existing U.S. GAAP. Instead, we recommend that the FASB leave existing standards in place until it can make a comprehensive reconsideration of accounting for nonmonetary transactions, perhaps in conjunction with the revenue recognition project.

Issue 1: Commercial Substance

Under existing IAS and US standards, an exchange of nonmonetary assets with determinable fair values is accounted for at fair value under certain circumstances and is accounted for at carryover basis under other circumstances. If an entity exchanges a 300-room hotel at the Columbus, Ohio airport for a 300-room hotel at the Sacramento, California airport, existing US GAAP would not permit gain recognition based on fair value, because the hotels are used in the same line of business, which causes them to be considered "similar," which means that the transaction does not culminate the earnings process. Under the Proposed Statement, gain would not be recorded based on fair value unless the entity could demonstrate that the amount, timing, or risk of the cash flows of the two hotels were different by an amount that is significant in relation to the fair value, because similarity of cash flows means that the transaction lacks "commercial substance."

We believe that the "similar productive asset" test in Opinion 29 is understandable. Further, thanks to the work of the EITF, the practice problems and differences in interpretation of the term "similar" are largely resolved.

The Board asserts that the "commercial substance" test, as defined in the proposed Statement, would be more representationally faithful that the "similar" test in Opinion 29. We disagree. We believe "commercial substance" as defined is not representationally faithful, and we believe that numerous interpretive and implementation issues will arise. Three examples will help illustrate our concerns with commercial substance as defined:

- Returning to the example of the two airport hotels, it is quite possible that the amount, timing, and risk of the cash flows are similar, because the assets are similar and have equal fair values. Intuitively, however, the transaction seems to have substance. The hotels are in different markets, and the parties may well have good business reasons—geographical expansion, diversification, etc.—for making the exchange. Although the accounting result in this particular case is the same as Opinion 29, it seems illogical to assert that the transaction lacks substance, whereas it is understandable to say that the assets are similar.
- Now, assume that the two airport hotels differ in size; one has 300 rooms, the other has 250 rooms. Further assume that the cash flows on a per room basis are identical. However, because of the size difference, the party that receives the 300-room hotel pays cash boot to the counterparty. The size difference and the cash boot change the timing of cash flows. That change in timing seems to lead to a conclusion that this transaction has commercial substance, whereas the first transaction doesn't. We believe that both examples have equivalent substance.
- Another example might involve an exchange of an office building for a shopping center of equivalent fair value. Both assets might have a mix of large (anchor) and small tenants of similar credit quality, with leases of similar duration, causing the amount, timing, and risk of the cash flows to be similar, even though the assets are quite different. Under Opinion 29, gain would be permitted, because the assets are dissimilar. The proposed Statement would indicate that the transaction lacks commercial substance because of the similarity of the cash flows, and gain would be prohibited.

Whereas the Board asserts that commercial substance as defined will be more representationally faithful than Opinion 29, we believe that commercial substance will be arbitrary and capricious and that the results often will be difficult to understand or explain. Further, we believe that the provision that the change in cash flows be "significant" in relation to the fair value of the assets exchanged will raise numerous implementation and interpretation questions. "Significant" in the context of cash flows is a new and undefined term. Confusion will reign until accountants in practice reach a consensus on what amount is "significant" and how it relates to "material."

In asking whether the commercial substance guidance is operational, the Board also asks whether the information needed to implement the requirement is currently available or can be created. We suspect that in many cases it is not currently available. In our experience, participants in nonmonetary exchanges typically do sufficient due diligence to determine the fair values of the assets being exchanged, but they do not necessarily develop explicit estimates of future cash flows. As we read the definition of commercial substance, entities would need explicit, probability-weighted distributions of future cash flows from each asset to compare the configurations of the cash flows. Developing those estimates would impose a cost that has no business benefit to the parties.

Issue 2: Scope, Oil and Gas

If the Board issues a final Statement, we agree with the scope exclusions for paragraphs 44(b) and 47(c) of FASB Statement No. 19. Given our discomfort with commercial substance as defined, we also would favor exclusion of transactions covered by paragraph 44(a) of Statement 19.

Issue 3: Scope, Real Estate

We have always thought it odd that under Opinion 29 it is possible to record gain on an exchange of real estate in which no cash is received but that under FASB Statement No. 66 it is impossible to record gain on a sale of real estate for 100% noncash monetary consideration. For example, if a hotel is sold in exchange for 100% U.S. Treasury bonds, which are liquid and free from credit risk, the buyer's cash down payment is inadequate under Statement 66 and no gain can be recorded. However, if the hotel were exchanged for a television station with a reasonably determinable fair value, gain could be recorded. We believe it would be more logical to eliminate the scope exception in Statement 66 than to perpetuate the inconsistent treatment of nonmonetary exchanges versus sales of real estate.

Issue 4: Equity Method Investments

We disagree with the proposed amendment of FASB Statement No. 140. While equity method investments are defined as financial assets, we believe that functionally most are closer to productive assets. As noted in the final section of this letter, the standards for gain recognition on exchanges of monetary assets are more lenient than the standards for gain recognition on exchanges of nonmonetary assets. As long as that difference persists, we believe that equity method investments should stay on the nonmonetary side.

Continuing Involvement

Paragraph 2 of the proposed Statement would state that a transfer "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) The basis for conclusions says that the Board analogized to the requirement in Statement 140 that a transferor must relinquish control of a monetary asset to qualify for sale accounting. The words in paragraph 2 go far beyond a requirement to relinquish control and also go far beyond the requirements of Statement 66. Statement 140 permits sale recognition even if the transferor retains substantial continuing involvement and substantial risk and reward of ownership through servicing or a residual interest. Statement 66 permits profit recognition, sometimes with adjustment, for sales with a variety of forms of continuing involvement. We recommend that the restriction be reworded, more consistent with existing accounting literature, to state that the transferor has no ***significant*** continuing involvement in the transferred asset such that control and a majority of the risks of ownership are transferred. If the Board wishes to retain the language in the proposed Statement, then the basis for conclusions should be changed, because the existing basis is inconsistent with the standard.

<u>A Comprehensive Reconsideration of Nonmonetary Transactions Is Needed</u>

Under both IAS and US standards, exchanges of monetary and nonmonetary assets are accounted for very differently. Exchanges of monetary assets are recorded at fair value, with recognition of gain permitted. Accordingly, if an entity exchanges a U.S. Treasury bond that matures in February 2013 for a U.S. Treasury bond that matures in March 2013, and meets the sale criteria of FASB Statement No. 140, the transaction is recorded at fair value even though the two bonds have identical credit risk and substantially similar cash flows and interest rate risk. Further, the entity need not demonstrate a non-accounting business purpose for the transaction. The transaction would be accounted for at fair value even if the entity's sole reason for consummating the transaction were to trigger earnings recognition of unrealized appreciation.

In a comprehensive consideration of nonmonetary transactions, the FASB should first decide whether it is appropriate to have different standards for recording exchanges of assets with determinable fair values depending on whether the assets are monetary or nonmonetary and, if so, why. If the FASB cannot identify a good reason why the standards should differ, then the standards for exchanges of assets with determinable fair values should be conformed. Conversely, if the FASB concludes that the standards for monetary and nonmonetary exchanges should differ, then it should identify logical and understandable principles for using fair value or carryover basis for nonmonetary assets. One logical approach would be to account for the exchange of nonmonetary assets at fair value only if the asset received is closer to cash (that is, more liquid, more readily salable, etc.) than the asset given up. We believe the principle of permitting gain recognition based on fair value only if the asset received is closer to cash would be more understandable than either Opinion 29 or the Proposed Statement.

We would be pleased to discuss our comments with the Board or staff. Please direct questions to Ben Neuhausen at 312-616-4661.

Very truly yours,

s/ BDO Seidman, LLP