

n y o r k s t a t e s o c i e t y o f

# NYSSCPA

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April 9, 2004

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

Letter of Comment No: 24  
File Reference: 1200-300  
Date Received: 4/13/04

By email: director@fasb.org

Re: File Reference 1200-300

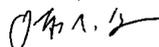
Exposure Draft: Proposed Statement of Financial Accounting Standards, *Exchange of Productive Assets, an amendment of APB Opinion No. 29*

Dear Ms. Bielstein:

The New York State Society of Certified Public Accountants, the oldest state accounting association, represents approximately 30,000 CPAs that will implement the provisions proposed in the captioned exposure draft. NYSSCPA thanks FASB for the opportunity to comment on its exposure draft.

The NYSSCPA Financial Accounting Standards Committee deliberated the exposure draft and prepared the attached comments with the consultation of the International Accounting and Auditing Committee. If you would like additional discussion with the committee, please contact Robert A. Dyson, chair of the Financial Accounting Standards Committee, at (212) 842-7565, or Robert Colson, NYSSCPA staff, at (212) 719-8350.

Sincerely,



Jeffrey R. Hoops  
President

Attachment

*new york state society of*

**NYSSCPA**

*certified public accountants*

530 fifth avenue, new york, ny 10036-5101  
www.nyscpa.org

**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON FASB EXPOSURE DRAFT**

**Proposed Statement of Financial Accounting Standards, *Exchange of Productive Assets, an amendment of APB Opinion No. 29***

**File Reference No. 1200-300**

**April 9, 2004**

**Principal Drafters**

**Robert A. Dyson  
Abraham E. Haspel  
Linda Lam  
Robert N. Waxman**

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## COMMENTS ON FASB EXPOSURE DRAFT

### Proposed Statement of Financial Accounting Standards, *Exchange of Productive Assets, an amendment of APB Opinion No. 29*

#### File Reference No. 1200-300

#### General Comments

Although the need for consistency in global accounting principles is desirable, such principles also should reflect the economic substance of transactions and be verifiable by outside auditors, as required by FASB Concepts Statement No. (CON) 2, *Qualitative Characteristics of Accounting Information*. The proposals in this exposure draft (ED) have shortcomings because they fail to satisfy the CON 2 requirements of the qualitative characteristics of representational faithfulness and verifiability.

The Accounting Principles Board (APB) issued Opinion No. 29, *Accounting for Nonmonetary Transactions*, to address certain abuses involving the reporting of non-monetary exchanges of similar assets in the 1960's and early 1970's. At that time, certain entities attempted to "manufacture" gains by exchanging various assets, including real estate, by recording the acquired assets at a perceived market value, and recognizing the difference between the carrying value of the disposed assets and the market value of the acquired assets as a gain. The APB endeavored to prevent such the reporting of such gains by linking the recognition of exchanges of similar assets to the culmination of the earnings process.

As discussed below, the ED would reverse the accounting appropriately established by the APB by potentially permitting two or more entities to manufacture gains by simply exchanging similar productive assets, such as real estate, with a relatively low historical cost, and valuing the acquired assets at a market or appraised value. The potential for abuse is particularly acute in transactions between related parties where the same individuals may influence the financial reporting of two or more entities. Such related parties may include public entities sharing a common independent director (e.g., one who is not a member of management) and nonpublic entities under common ownership. In this era of financial reporting scandals, revocation of an accounting principle that effectively addressed earlier financial reporting scandals is not desirable.

#### Issue 1 – Commercial Substance

The guidance on commercial substance is not operational. Specifically, the criteria for commercial substance is not consistent with FASB's intent, as discussed in paragraph 1 of the ED, to measure assets acquired in a nonmonetary transaction at fair value. The ED, in effect, gives reporting entities the ability to measure assets acquired in

an arm's length transaction and the related gain using their own, as opposed to market place, criteria.

The proposal addresses exchanges of assets between willing parties who, in effect, determined a price based on the assets and liabilities given up. These assets would include similar productive assets, which Opinion 29, paragraph 3e, defines as "productive assets that are of the same general type, that perform the same function or are employed in the same line of business." The participants in the transaction have already determined that the exchanged assets have the same fair values, as evidenced by their exclusion of other consideration, such as cash, from the transaction. The willingness to exchange assets with the same fair value implies that the participants understood that no gain or loss would result from the exchange. Any perceived differences in cash flows derived from the transaction would be reflected by including cash or other assets in the exchange to compensate for differences in those values. Opinion 29 recognizes this economic reality by allowing gain recognition to the extent of the amount of boot received in the exchange. Thus, the Board is potentially proposing to value acquired assets and liabilities at future cash flows and to recognize gains and losses in transactions where no gain or loss was apparently contemplated.

The ED eliminates the similar asset comparisons required by APB 29 and requires the determination of commercial substance. In order to determine commercial substance, an entity must determine the existence of a difference in the configuration (risk, timing or amount) of the expected cash flows of the exchanged assets specific to its use of that asset. This procedure, in effect, requires the entity to substitute its assumptions for those made by market place participants.

The use of the reporting entity's assumptions, instead of those reflected in the marketplace, revises the method of determining fair value. As presented in paragraph 5 of SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*, and other pronouncements, the Board has defined fair value as the amount determined in a current transaction between willing parties, other than a forced or liquidation transaction. If quoted market prices, the best evidence, are not available, various alternative methods of estimating fair value, such as those based on future cash flows, are available. CON 7, *Using Cash Flow Information and Present Value in Accounting Measurement*, paragraphs 36 to 38, considers marketplace factors to be a crucial element in determining fair value based on the present value of future cash flows.

The entity's assumptions applied in determining commercial substance require a high degree of subjectivity, which is difficult to verify. The estimate of future cash flows itself is inherently subjective. In many instances, the cash flows associated with the acquired assets will be highly dependent upon their integration into a company's operations and the related business model, which introduces an additional level of subjectivity to an existing subjective calculation. The fact that gains recognition can be estimated does not make those criteria any less subjective. The subjectivity inherent in the ED may encourage entities to structure exchange transactions to give the appearance

of differences in estimates of future cash flows when in fact no substantive difference exists.

## **Issue 2 – Scope Exceptions**

Paragraph 2 of the ED specifies that a transfer of nonmonetary assets is not an exchange unless the transferor has no continuing involvement such that all the risks and rewards of ownership of the asset are transferred. Additional guidance is necessary to define the concept of “continuing involvement,” as applicable to nonmonetary exchanges of assets. The current guidance on “continuing involvement,” presented in SFAS 66, *Accounting for Sales of Real Estate*, paragraphs 6, 18 and 43 and SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, paragraph 9, describes “continuing involvement” only in to the context of those statements, and does not provide adequate general guidance for all nonmonetary exchanges of productive assets.

For example, assume a company exchanges a manufacturing facility for another facility and simultaneously enters into a contract with the transferee to use the facility to manufacture a certain amount of inventory for the transferor. The ED is not clear as to how to measure the significance of the continuing involvement to determine whether the risks and rewards of ownership have sufficiently been transferred. Some general criteria should be established about identifying and measuring the significance of the continuing involvement.

In addition, the proposal eliminates guidance on exchanges of assets for equity securities of the entity receiving the asset. In paragraph A7, the Board seems to be deferring issuing new guidance until it completes its projects on revenue recognition and new basis accounting. As of April 9, 2004, however, the Board has not scheduled to issue an exposure draft on revenue recognition until the fourth quarter of 2004 and has no target date for issuing an exposure draft on new basis accounting. Until such final guidance is issued, the Board should either leave the current guidance in effect or, after proper exposure, issue additional guidance as to the accounting and disclosure of an exchange of assets for equity or when a transfer of nonmonetary assets does not qualify as an exchange.

## **Issue 3 – Real Estate**

For the reasons discussed in Issues 1 and 2, the current standards governing the exchange of real estate adequately reflects the economic substance of such exchanges and they should not be changed.

## **Issue 4 – Exchanges of Equity Method Investments**

The Board should further consider the implications of the proposal to measure equity method investments acquired in a nonmonetary exchange at fair value, as required by SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and*

*Extinguishments of Liabilities.* An exchange of equity method investments measured at fair value may result in the carrying value of the investment to differ from the underlying equity in the assets of the investee. Applying APB 18, *The Equity Method of Accounting for Investments in Common Stock*, paragraph 19(n), the difference would then be considered goodwill. Following SFAS 142, *Goodwill and Other Intangible Assets*, paragraph 59, this goodwill would not be amortized, but rather tested for impairment. Thus, the ED would require the equity method investment be carried at adjusted cost, as required by the present standard, with an additional amount presented as goodwill. This is not useful information.