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Financial Accounting Series

EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards

Exchanges of Productive Assets

an amendment of APB Opinion No. 29

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Major Projects and Technical Activities
File Reference No. 1200-300

Comment Deadline: April 13, 2004

Financial Accounting Standards Board
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be *received* in writing by April 13, 2004. Interested parties should submit their comments by email to **director@fasb.org**, File Reference 1200-300. Those without email may send their comments to the "MP&T Director—File Reference 1200-300" at the address at the bottom of this page. Responses should *not* be sent by fax.

Any individual or organization may obtain one copy of this Exposure Draft without charge until April 13, 2004, on written request only. Please ask for our Product Code No. E175. For information on applicable prices for additional copies and copies requested after April 13, 2004, contact:

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Notice for Recipients
of This Exposure Draft

This proposed Statement would eliminate paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* which establishes an exception to the general principle that exchanges of nonmonetary assets should be recorded at the fair value of the assets exchanged. This proposed Statement would require that exchanges of productive assets be accounted for based on the fair values of the assets involved, unless the exchange transaction does not have commercial substance. For example, Company A has a warehouse in Ohio with a carrying amount of $1 million and a fair value of $3 million. If Company A exchanged its warehouse in Ohio for Company B's warehouse in California, Company A would recognize a $2 million gain on the warehouse in Ohio and record the warehouse in California at its fair value, unless the transaction did not have commercial substance for Company A. Commercial substance would be assessed by comparing the expected cash flows of the entity immediately before and after the exchange. The exception to fair value accounting for nonmonetary exchanges of productive assets for which the fair value of neither the asset received nor the asset surrendered is determinable within reasonable limits remains unchanged by this proposed Statement.

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement. Comments are requested from those who agree with the provisions of this proposed Statement as well as from those who do not.

Comments are most helpful if they identify the specific paragraph or group of paragraphs to which they relate and clearly explain the problem or question. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning.

Issue 1: Commercial Substance. Is the commercial substance guidance operational? By operational, the Board means:

a. The proposed standard is comprehensible by a reader who has a reasonable level of business or accounting knowledge and sophistication.
b. The information needed to implement the requirement is currently available or can be created.
c. The results of applying the requirement are those intended by the Board.

If not, what changes would be necessary to make the commercial substance guidance operational? Would the proposed changes to Opinion 29 discourage inappropriate gain recognition or deferral? If not, what changes would be necessary to do so? Paragraphs A10 and A11 discuss the basis for the Board's decision on this matter.

Issue 2: Scope Exceptions. This proposed Statement would exclude from its scope transactions that embody a transfer of assets to an entity in exchange for an interest in that entity, as well as transactions involving the exchange of a part of an operating interest owned by one party for a part of an operating interest owned by another party that are subject to paragraphs 44(b) and 47(e) of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies.* However, transactions that are subject to paragraph 44(a) of Statement 19 would be subject to the provisions of this proposed Statement. Are the scope exceptions appropriate? If not, why not? Paragraphs A7 and A8 discuss the basis for the Board's decision on this matter.

Issue 3: Real Estate Transactions. FASB Statement No. 66, *Accounting for Sales of Real Estate*, states that exchanges of real estate for other real estate are not within its scope and should be accounted for under the provisions of Opinion 29. The Board considered whether to eliminate that exception to the scope of Statement 66 but tentatively decided not to do so because Statement 66 was designed to deal with transactions involving monetary consideration. Do you agree that nonmonetary exchanges of real estate should continue to be accounted for under Opinion 29 as amended by this Statement? If not, how could Statement 66 be amended to address issues related to nonmonetary transactions? Paragraph A9 discusses the basis for the Board's decision on this matter.

Issue 4: Amendment of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* This proposed Statement would eliminate the scope exception for exchanges of equity method investments for similar productive assets in Statement 140. Thus, all transfers of equity method investments would have to meet the conditions in Statement 140 before the transferor could derecognize its interests. Exchanges of equity method investments for similar productive assets would no longer be accounted for under Opinion 29. Do you agree that exchanges of equity method investments for similar productive assets should be accounted for within the scope of Statement 140?

Summary

This proposed Statement would eliminate paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* which establishes an exception to the general principle that exchanges of nonmonetary assets should be recorded at the fair value of the assets exchanged. This proposed Statement would require that exchanges of productive assets be accounted for based on the fair values of the assets involved, unless the exchange transaction does not have commercial substance. Commercial substance would be assessed by comparing the expected cash flows of the entity immediately before and immediately after the exchange. The exception to fair value accounting for nonmonetary exchanges of productive assets for which the fair value of neither the asset received nor the asset surrendered is determinable within reasonable limits remains unchanged by this proposed Statement.

Reasons for Issuing This Proposed Statement

In October 2002, the FASB and the International Accounting Standards Board (IASB) undertook a joint project to achieve more comparability in cross-border financial reporting through convergence to a single set of high-quality accounting standards. Each Board reviewed its pronouncements for areas of its generally accepted accounting principles (GAAP) that could be improved by converging with the other Board's GAAP. Accounting for nonmonetary exchanges of productive assets was identified as an area in which the U.S. standard could be improved by eliminating differences between Opinion 29 and changes to IAS 16, *Property, Plant and Equipment,* and IAS 38, *Intangible Assets,* proposed in the IASB's Exposure Draft, *Improvements to International Accounting Standards.*

How the Changes in This Proposed Statement Would Improve Financial Reporting

Under Opinion 29, the accounting for nonmonetary exchanges of productive assets was based on whether the assets exchanged were similar to prevent inappropriate gain recognition. This proposed Statement would base the accounting for the transaction on whether it has commercial substance. By focusing on each asset's entity-specific value and cash flows to determine whether a transaction has commercial substance (and, if so, to recognize the transaction at the fair value of the assets exchanged), the proposed accounting would present a more representationally faithful portrayal of the economics of the transaction. The Board believes that the similar productive asset exception required that some transactions, although commercially substantive, be recorded on a carryover basis. This proposed Statement would require that all commercially substantive exchange transactions for which the fair values of the assets exchanged are reliably determinable be recorded at fair value, whether or not they are exchanges of similar productive assets.

The provisions of this proposed Statement would also increase convergence with proposed International Financial Reporting Standards in accordance with the Board's goal of promoting the international convergence of accounting standards concurrent with improving the quality of financial reporting.

Proposed Statement of Financial Accounting Standards

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an amendment of APB Opinion No. 29

December 15, 2003

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INTRODUCTION

1. This Statement bases the measurement of the asset acquired in a nonmonetary exchange of productive assets on the asset's fair value, if the transaction has commercial substance. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions.*

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendments to Opinion 29

2. The following sentence is added at the end of paragraph 3(c) of Opinion 29 (definitions):

> A transfer of a nonmonetary 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.

3. The following subparagraphs are added after paragraph 4(d) of Opinion 29 (scope exceptions):

   e. Transactions that embody a transfer of assets to an entity in exchange for an interest in that entity
   f. Transactions described in paragraph 44(b) of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies,* as a pooling of assets in a joint undertaking intended to find, develop, or produce oil or gas from a particular property or group of properties
   g. Transactions involving the exchange of a part of an operating interest owned for a part of an operating interest owned by another party that are subject to paragraph 47(e) of Statement 19
   h. Transactions involving the transfer of a financial asset within the scope of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

4. Paragraphs 20 and 21 of Opinion 29 are replaced by the following paragraphs and new heading:

> 20. The accounting for a nonmonetary exchange shall be based on the recorded amount (after reduction, if appropriate, for an indicated impairment of value) of the nonmonetary asset relinquished, and not on the fair value of the transferred asset, if any of the following conditions apply.
>
> a. *Fair Value Not Determinable.* The fair value of neither the asset(s) received nor the asset(s) relinquished is determinable within reasonable limits (paragraph 25).
> b. *Exchange Transaction to Facilitate Sales to Customers.* The transaction is an exchange of a product or property held for sale in the ordinary course of business for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange.
> c. *Exchange Transaction That Lacks Commercial Substance.* The transaction lacks commercial substance (paragraph 21).
>
> **Commercial Substance**
>
> 21. There are two steps necessary to determine whether a nonmonetary exchange has commercial substance. In the first step, the entity determines whether its future cash flows are expected to change as a result of the exchange. To do this the entity considers whether:
>
> a. The configuration (risk, timing, or amount) of the expected future cash flows of the asset(s) received differs from the configuration of the expected future cash flows of the asset(s) transferred, or
> b. The entity-specific value* of the portion of the reporting entity's operations affected by the transaction changes as a result of the exchange.
>
> If the entity's future cash flows are expected to change as a result of the exchange, in the second step the entity assesses whether either of the differences in (a) or (b) is significant relative to the fair value of the assets exchanged. If either of the differences is significant, the transaction has commercial substance.
>
> In the United States and some other tax jurisdictions, tax rules provide that a transaction is not to be given effect for tax purposes unless it serves a legitimate business purpose other than tax avoidance. Commercial substance must not be predicated on tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result.

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*Entity-specific value is discussed in paragraph 24 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements.*

Other Amendments to Existing Pronouncements

5. Paragraph 44(a) of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies,* as amended by FASB Statements No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, and No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*, is deleted.

6. In the first sentence of paragraph 4 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*, the phrase *exchanges of equity method investments for similar productive assets,* is deleted.

7. Statement 144 is amended as follows:

a. In the first sentence of paragraph 27, *in an exchange for a similar productive long-lived asset,* is deleted.

b. In the heading preceding paragraph 29, *to Be Exchanged for a Similar Productive Long-Lived Asset or* is deleted.

c. The first sentence of paragraph 29 is replaced by the following:

> For the purposes of this Statement, a long-lived asset to be distributed to owners in a spinoff is disposed of when it is distributed.

d. Footnote 17 is replaced by the following:

> The provisions of this paragraph apply to nonmonetary exchanges that are not recorded at fair value under the provisions of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, as amended, either because the fair value is not determinable within reasonable limits or because the transaction lacks commercial substance.

Effective Date and Transition

8. The provisions of this Statement shall be effective for nonmonetary asset exchanges in fiscal years beginning after December 15, 2004. The provisions of this Statement shall be applied prospectively.

The provisions of this Statement need not be applied to immaterial items.

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

A2. In September 2002, the FASB and the International Accounting Standards Board (IASB) (collectively the Boards) made a commitment to converge the accounting standards of their respective jurisdictions through a long-term convergence plan. As part of that plan, the Boards jointly undertook a short-term project to eliminate certain differences between the accounting pronouncements of the IASB and the accounting pronouncements in effect in the United States. Both Boards agreed to limit the scope of the short-term project to issues for which (a) the Boards' respective accounting pronouncements were divergent; (b) convergence to a high-quality solution would appear to be achievable in the short-term, usually by selecting between the existing standards of either the FASB or the IASB; and (c) the issue was not within the scope of other projects on the current agendas of either Board. The Boards hope that before the European Commission's 2005 target date for adoption of international financial reporting standards (IFRS) by all European Union listed companies, the short-term convergence project will simplify cross-border financial reporting by reducing the number of items required for reconciliation of U.S. generally accepted accounting principles (GAAP) and IFRS.

Nonmonetary Asset Exchanges

A3. In May 2002, the IASB issued its Exposure Draft, *Improvements to International Accounting Standards*, which among other things proposed changing the accounting for exchanges of similar productive assets classified as property, plant, and equipment or intangible assets. The proposed accounting would eliminate the "similar productive asset" exception to fair value measurement of assets received in nonmonetary exchanges. The IASB affirmed that decision during redeliberations, with the added proviso that exchanges lacking commercial substance would not qualify for recognition at fair value.

A4. The FASB noted that the guidance in Opinion 29 that requires a determination of whether a nonmonetary exchange is an exchange of similar productive assets has been difficult to apply. For example, EITF Issues No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," and 01-2, "Interpretations of APB Opinion No. 29," involve detailed guidance that addresses when the similar productive assets exception should apply. The Board decided that an approach that was more clearly tied to the commercial substance of the exchange would be preferable. Thus, the Board decided to converge with the accounting for nonmonetary asset exchanges proposed in the IASB Exposure Draft on improvements. That is, a nonmonetary exchange should be accounted for at fair value unless (a) neither the asset(s) received nor the asset(s) surrendered has a fair value that is determinable within reasonable limits, (b) the transaction is an exchange of assets for sale in the normal course of business for assets for sale in the same line of business (inventory exchanges), or (c) the transaction lacks commercial substance.

A5. The Board noted that eliminating the similar asset exchange exception in Opinion 29 might result in significant changes in practice. For example, this Statement requires that asset(s) received in exchange transactions described in paragraph 44(a) of Statement 19 (as amended by Statements 144 and 145) be measured at their fair value(s) unless the transaction lacks commercial substance or the fair value of neither the asset received nor the asset surrendered is determinable within reasonable limits. Also, this Statement requires that a transfer of an equity method investment for a similar productive asset be accounted for in accordance with the provisions of Statement 140. However, the FASB reiterated its commitment to working with the IASB to converge the standard setters' pronouncements and stated that U.S. GAAP will be improved by the elimination of the similar productive asset exception in favor of a more robust test of the commercial substance of the transaction.

A6. 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 in the transferred asset.

Scope Exceptions

A7. The Board noted that including transactions that embody a transfer of assets to an entity in exchange for an interest in that entity within the scope of this Statement may presuppose answers to issues being addressed in its projects on revenue recognition and new basis accounting. Thus, the Board decided not to include those transactions within the scope of this Statement. The Board also noted that the transactions described in paragraph 44(b) of Statement 19 have the same characteristics as the scope exception described above and decided to provide a scope exception for those transactions.

A8. The Board noted that in Statement 19 the transactions described in paragraph 47(e) are described as exchanges of similar productive assets. The Board considered whether to amend paragraph 47(e) of Statement 19 to require that the transactions described be accounted for under the provisions of this Statement. The Board noted that it is difficult to distinguish "joint venture" transactions from similar transactions that would be included in the scope of Statement 19 because *joint venture* is not defined robustly in current guidance. Thus, the Board decided to provide a scope exception for the transactions described in paragraph 47(e) of Statement 19.

A9. FASB Statement No. 66, *Accounting for Sales of Real Estate*, provides guidance on when to derecognize a real estate asset sold and when to recognize profit on the sale of that asset. Statement 66 states that exchanges of real estate for other real estate should be accounted for under the provisions of Opinion 29. The Board considered whether to eliminate the scope exception to Statement 66 but decided not to do so because that Statement was designed to deal with transactions involving monetary consideration. The Board decided that the model established by this Statement is appropriate for evaluating exchanges of real estate for real estate.

Commercial Substance

A10. The FASB and the IASB worked together to describe the notion of commercial substance. The Boards identified four perspectives from which a reporting entity could evaluate commercial substance: (a) attributes of the reporting entity making the exchange, (b) attributes of the assets being exchanged, (c) attributes of the counterparty to the exchange, and (d) attributes of the terms of the exchange. The FASB and the IASB both concluded that evaluating commercial substance from the reporting entity's perspective would be most useful because such an evaluation would focus on changes in the economic situation of the reporting entity as a result of the exchange.

A11. Both Boards concluded that changes to the economics of the reporting entity should be evaluated by comparing changes in the entity's expected future cash flows—specifically, either (a) the configuration (risk, timing, or amount) of the estimated future cash flows underlying the asset received as compared with the configuration of those underlying the asset surrendered or (b) the entity-specific value of the portion of the reporting entity's operations affected by the transaction immediately before and immediately after the exchange. The FASB concluded that an approach that evaluates the risk, timing, and amount of future cash flows and the entity-specific value of the portion of the reporting entity's operations affected by the transaction is more operational than an approach that evaluates whether the exchanged assets are similar. The Boards concluded that the portion of the reporting entity's operations affected by the transaction could be confined to the assets exchanged, or it could be a larger portion of the operations. In either case, the Boards decided to require that significance of changes in cash flows be assessed in relation to the fair value of the exchange.

Tax Cash Flows

A12. The Board understands that the tax rules in the United States and some other tax jurisdictions incorporate a business-purpose doctrine. Under that doctrine, a transaction is not to be given effect for tax purposes unless it serves a legitimate business purpose other than tax avoidance. The interaction between the commercial-substance exception and the business-purpose doctrine could be viewed as circular, if (a) the determination of commercial substance is predicated solely on changes in tax cash flows and (b) the tax business purpose asserted is the achievement of a specified financial reporting result. The

Board addressed this potential circularity by prohibiting entities from asserting commercial substance if that assertion is predicated on tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result.

Fair Value Determinable within Reasonable Limits

A13. The FASB noted that the exception in Opinion 29 for exchanges in which the fair value is "not determinable within reasonable limits" has the same intent as the IASB's exception for nonmonetary asset exchanges in which the fair value of the assets exchanged is not "reliably measurable." Each Board decided to retain its current terminology pending completion of its project on fair value measurement.

Scope Convergence

A14. Opinion 29 provides guidance on accounting for nonmonetary transactions. IAS 16, *Property, Plant and Equipment,* and IAS 38, *Intangible Assets,* provide guidance on the accounting for these two types of assets. Both Boards acknowledge that those differences will likely result in scope differences between the Boards' standards for nonmonetary exchanges. The FASB and the IASB have agreed to use an iterative process to converge the scope of their guidance for nonmonetary exchanges. Under that process, the IASB plans to issue its proposed standard for nonmonetary asset exchanges with a more narrow scope than the FASB's proposed standard. The FASB will then incorporate any improvements in the notions of *commercial substance* and *determinable within reasonable limits* (also known as *reliably measurable* in the proposed IASB standard) as part of its due process for this Statement. Once the FASB has issued a Statement on nonmonetary exchanges, the IASB will then add a project to its agenda to converge its standard, in terms of both scope and content (if necessary), with that of the FASB. The Board noted that its decision to amend Statement 140 brought the scope of this Statement closer to the scope of the proposed IASB changes.

Effective Date and Transition

A15. The Board decided that the provisions of this Statement should be effective for fiscal years beginning after December 15, 2004, so that entities based in the European Union that report under U.S. GAAP would have time to implement its provisions prior to the 2005 target date for reporting under IFRS.

A16. As part of its short-term convergence project, the Board is reexamining its provisions for accounting changes. The Board issued a proposed Statement on accounting changes concurrent with issuance of the Exposure Draft for this Statement. That proposed Statement would deem retrospective application impracticable if (a) the effects of retrospective application are not determinable, (b) retrospective application requires assumptions about management's intent in a prior period, or (c) retrospective application requires significant estimates as of a prior period for which it is not possible to objectively distinguish between information that would have been available at the time the affected transactions or events would have been recognized in the financial statements and information that arose subsequent thereto. The Board intends to begin its short-term convergence redeliberations with the proposed Statement on accounting changes. The transition provisions of this Statement are in accordance with that proposed Statement. The Board concluded that prospective application of the provisions of this Statement is appropriate because retrospective application requires assumptions about management intent in a prior period and may require significant estimates as of a prior period for which it is not possible to objectively distinguish between information that would have been available at the time the affected transactions or events would have been recognized in the financial statements and information that arose subsequent thereto.

Benefits and Costs

A17. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—and other users of financial information benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

A18. The Board believes that the benefits of a more conceptually based standard for accounting for the exchange of productive assets should outweigh any effort that would be required on the part of preparers to determine whether a nonmonetary exchange of productive assets has commercial substance. Further, the Board notes that costs would be reduced for entities that prepare financial statements for use in several jurisdictions, because convergence with international accounting standards will reduce the time and effort necessary to prepare reconciliations between U.S. GAAP and IFRS. The Board believes that financial reporting will be both simplified and improved by eliminating the inconsistencies between U.S. GAAP and IFRS.

Appendix B

IMPACT ON EITF ISSUES

B1. This appendix addresses the impact of this Statement on the consensuses reached on EITF Issues relating to nonmonetary exchanges of productive assets. This appendix does not address the impact of this Statement on other authoritative accounting literature included in categories (b), (c), and (d) in the GAAP hierarchy discussed in AICPA Statement on Auditing Standards No. 69, *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles" in the Independent Auditor's Report.*

Issue Number	Title	Status	Analysis
98-3	Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business	Status Updated	Issue 98-3 was raised in response to questions related to whether certain exchanges should be considered exchanges of productive assets or exchanges of businesses. The status of that Issue is updated to note that while the original purpose for the Issue—the similar productive assets exception in paragraph 21(b) of Opinion 29—has been eliminated, the Board finds the description of a business helpful in other areas and has decided to retain it.
01-2	Interpretations of APB Opinion No. 29	Partially Nullified	The Task Force addressed numerous issues related to Opinion 29. This Statement nullifies the following issues: 1–7, 8(b), and 9. Issue 10(b) would reference the amendment of Opinion 29. Also, the example following 10(b) referencing similar productive assets would be amended to change the facts from noting that the transaction was for similar real estate to note that the nonmonetary portion does not meet the commercial substance criteria.