

Defining Issues[®]

KPMG LLP (US)



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Accounting for Nonmonetary Transactions

Companies will no longer be permitted to use the “similar productive assets” concept to account for nonmonetary exchanges at book value with no gain being recognized, according to a new FASB Statement that amends APB Opinion 29.¹ Nonmonetary exchanges have to be accounted for at fair value, recognizing any gain or loss, if the transactions meet a commercial-substance criterion and fair value is determinable. The amendment is an outgrowth of the project to reduce differences between U.S. and international standards and will be effective for nonmonetary transactions occurring in fiscal periods beginning after June 15, 2005.

Eliminating the “Similar Productive Assets” Exception

Productive assets are assets used to produce goods or services or held for that purpose. Productive assets are similar if they “are of the same general type,” perform the same function, or are employed in the same line of business.² Nonmonetary productive assets could include inventories and property, plant, and equipment.

The amendment eliminates the exception to the fair-value principle for exchanges of “similar productive assets,” which had been accounted for based on the book value of the asset surrendered with no gain recognition. In the course of eliminating the exception, the amendment also eliminates Opinion 29’s concept of culmination of the earnings process and nullifies guidance on how to apply the similar-productive-asset exception that had been issued by the EITF and is no longer needed.³

The amendment leaves intact Opinion 29’s general requirement that nonmonetary exchanges of assets be accounted for at fair value with gain or loss recognition. It also leaves intact the exceptions for inability to determine fair value within reasonable limits and for exchange transactions between parties in the same line of business to facilitate sales to customers. An example of an exchange to facilitate a sale is an exchange of one type of inventory for another in order to sell the newly acquired inventory to a customer.

¹ FASB Statement No. 153, Exchanges of Productive Assets, an amendment of APB Opinion No. 29, December 2004; APB Opinion No. 29, Accounting for Nonmonetary Transactions, May 1973.

² The definitions are in par. 3 (e) of Opinion 29.

³ EITF Issue No. 01-2, Interpretations of APB Opinion No. 29.

The “Commercial Substance” Criterion

The amendment requires that an exchange of nonmonetary assets be accounted for at fair value if the exchange has commercial substance and fair value is determinable within reasonable limits. Commercial substance is assessed by comparing the entity’s expected cash flows immediately before and after the exchange. Specifically, the entity assesses whether either of the following is significant.

- The difference between the amount, timing, and risk of the expected cash flows to be generated by the assets received and by the assets transferred.⁴
- The difference between the “entity-specific measurement” of the assets received and those transferred, based on the explanation of “entity-specific measurement” in Concepts Statement 7. The “entity-specific value” of the assets as the entity expects to use them is not fair value, because the entity’s use of the assets may differ from their use by other marketplace participants.⁵ The significance of the difference between the entity-specific-measurements should be evaluated by comparison to the fair value of the assets exchanged.

If either difference is significant, the transaction has commercial substance and should be recognized at fair value.

Commercial substance is not supportable by tax cash flows if those cash flows depend entirely on supporting the transaction’s business purpose for tax accounting by a claim

to a specified financial-reporting result (i.e., the tax claim is supported only by the gain recognition for financial-reporting purposes).

The boxed example illustrates the difference between the “commercial substance” and “similar productive asset” approaches.

Real-Estate Transactions

Exchanges of real estate for other real estate are within the scope of Opinion 29. However, to prevent gain recognition on exchanges of

real estate when the risks and rewards of ownership are not fully transferred, the amendment precludes a gain from being recognized if the entity has significant continuing involvement with the real estate given up in the exchange.

Exchange of Equity-Method Investments

Exchanges of equity-method investees had been excluded from the scope of Statement 140 and were, therefore, accounted for as nonmonetary exchanges under Opinion 29.⁶

Example Comparing the New and Superseded Requirements

Because of changes in its business, ABC Company needs only one of its two warehouses in the New York metropolitan area. However, because of growth in its Midwest operations, ABC needs an additional warehouse in Chicago.

ABC has identified an unrelated company in Chicago that needs a warehouse in New York and is willing to exchange its Chicago warehouse to obtain one in New York. The fair value of each warehouse is determined to be \$200,000. The book value of ABC’s New York warehouse is \$125,000.

Using the Superseded “Similar Productive Assets” Concept. Because the assets to be included in the exchange are similar productive assets, the exchange would be accounted for at book value with no gain recognition. The new warehouse would be recorded at the book value of the warehouse surrendered (\$125,000).

Using the New “Commercial Substance” Concept. Because the Chicago warehouse enables ABC to expand its operations in the Midwest, the expected cash flows after the exchange would be greater than the expected cash flows before the exchange. Therefore, the exchange would have commercial substance and would be recognized at fair value. A gain of \$75,000 would be recognized on the asset surrendered (fair value of \$200,000 – book value of \$125,000). The asset received would be recorded at fair value (\$200,000).

⁴ FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, February 2000, pars. 62-71.

⁵ FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, February 2000, par. 24 (b).

⁶ FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, September 2000.



The new Statement removes the scope exception for exchanges of equity-method investments from Statement 140. All transfers of equity-method investments now have to meet the sale criteria in Statement 140 before the transferor can derecognize its interest in the equity-method investee.



Both the FASB and the IASB acknowledge that differences remain between the new FASB Statement and the requirements in IAS 16.⁷ The IASB plans to issue a proposed standard for nonmonetary asset exchanges to narrow those differences. If the IASB adopts those changes, the FASB is expected to incorporate into Opinion 29 any improvements the IASB has made, focusing particularly on improvements in applying the notions of commercial substance and determinable within reasonable limits.

The descriptive and summary statements above are not necessarily applicable to any company's particular circumstances and are not intended to substitute for the text of APB Opinion 29, IAS 16, and FASB Statements 140 and 153. Companies applying these requirements should consult the relevant text and their accounting and legal advisors.

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⁷ International Accounting Standard 16, Property, Plant and Equipment, December 2003.