REVISED MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Short-Term Convergence—Phase 1 Varian (ext. 353)		
Subject:	Revised Minutes of the September 15, 2004 Board Meeting	**Date:**	September 23, 2004
cc:	Bielstein, Smith, Leisenring, Swift, Polley, Gabriele, Intranet (email), Project Team (J. Johnson, McKenna, Varian, Vincent), McGeachin (IASB via e-mail)		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Exchanges of Productive Assets

Basis for Discussion: Memorandum Dated September 3, 2004

Length of Discussion: 11:00 am to 12:00 p.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Schieneman, Schipper, Seidman, and Trott
Board members absent:	None
Staff in charge of topic:	J. Johnson
Other staff at Board table:	Beilstein, Cassel, McKenna, Varian
Outside participants:	Leisenring

<u>Summary of Decisions Reached</u>:

The Board redeliberated the provisions of the December 2003 FASB proposed Statement, *Exchanges of Productive Assets* (an amendment to APB Opinion No. 29). The Board made the following decisions:

1. Affirmed its decision to require that a cash flow test be used to determine whether a nonmonetary exchange of productive assets has commercial substance. The Board decided to clarify, however, that a qualitative assessment will, in some cases, be conclusive in determining whether the commercial substance criterion is met.

2. Decided to modify the commercial substance test described in paragraph 21 of the proposed Statement. Specifically, the Board decided that commercial substance may be established by assessing the change in configuration of cash flows, without regard to the significance of that change to the fair values of the exchanged assets. The Board also decided that paragraph 21(b) of the proposed requirements should be revised to exclude the phrase *portion of the reporting entity's operations*. The new requirement will read as follows:

    > 21. To determine whether a nonmonetary exchange has commercial substance, the entity determines whether its future cash flows* are expected to change as a result of the exchange. A transaction has commercial substance if either:
    >
    > a. The configuration (risk, timing, or amount) of the expected future cash flows of the asset(s) received differs significantly from the configuration of the expected future cash flows of the asset(s) transferred, or
    >
    > b. The entity-specific value* of the asset(s) received differs from the entity-specific value of the asset(s) transferred, and the difference is significant in relation to the fair value of the assets exchanged.
    >
    > *Calculation of expected future cash flows and entity-specific value is discussed in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*.

3. Consistent with the provisions of the Exposure Draft, decided not to:

    a. Require disclosure of the circumstances surrounding, or the reasons for, a nonmonetary asset exchange.

    b. Include example transactions in the final Statement.

4. Affirmed the following provisions in the Exposure Draft:

a. The requirement that 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 should be retained.

b. The scope of the Exposure Draft should remain as is except for the following revision to paragraph 3(c) of Opinion 29:

> A transfer of a nonmonetary asset is not considered an exchange unless the transferor has no *significant* continuing involvement in the transferred asset such that *substantially all* the risks and rewards of ownership of the asset are transferred. [Emphasis added.]

c. FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, will be amended to eliminate the scope exception for exchanges of equity method investments for similar productive assets.

d. The final Statement will be effective on a prospective basis for nonmonetary asset exchanges in fiscal years beginning after December 15, 2004.

Objective of Meeting:

The objective of the Board meeting was to redeliberate certain remaining issues related to the Exposure Draft.

Matters Discussed and Decisions Reached:

Ms. McKenna began by stating that the first issue to be discussed was whether to replace the cash flow test in the proposed Statement with a more principles based approach for determining whether commercial substance exists. She recommended that the Statement be finalized as proposed because the suggestions made by respondents did not reflect any information that the Board did not consider during its initial deliberations.

Ms. Seidman addressed the staff recommendation of including the last sentence of paragraph 25 of IAS 16, *Property, Plant and Equipment*. That sentence states:

> The result of these analyses may be clear without an entity having to perform detailed calculations.

She suggested that the basis for conclusions clarify that this sentence does not mean that one would use an approach different from an analysis of the cash flows. She was concerned that respondents may think that adding this sentence addresses their concerns about exchanges of dissimilar assets with similar cash flows. Mr. Leisenring stated that the last sentence of paragraph 25 of IAS 16 was added to make it easier for preparers to implement by allowing them to forgo the detailed calculation if the answer was obvious. He further clarified that there would always have to be assessment of the cash flows, but if it was clear that the cash flows would be different, then one does not have to make the detailed calculation.

Ms. Seidman stated that she was concerned about using this cash flow test in the context of this project. She stated the scope of Opinion 29 on nonmonetary transactions is much broader than the scope of IAS 16. She was concerned that this project is using an inconsistent principle in relation to other projects on the agenda. For example, in the Statement 140 amendment project, the majority of the board believes that retained interests should be remeasured to fair value because the nature of the asset has changed after a securitization, without regard to the significance of the change or a cash flow calculation. Mr. Johnson stated that the scope exceptions were specifically devised so that the principle decided upon in this project would not interfere with other transactions covered by Statement 140 that had other complications.

All Board members agreed with the staff’s recommendation to retain the guidance that the cash flow test be used for evaluating whether commercial substance exists in a nonmonetary asset exchange. The Board also decided to clarify that, for some exchange transactions, the results of a commercial substance analysis may be clear without an entity having to perform detailed cash flow computations.

Mr. Johnson stated that paragraph 21(a) of the proposed Statement requires entities to determine whether the configuration 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. Proposed paragraph 21 requires the results of that calculation to then be compared to the relative fair value of the assets exchanged. He stated that an assessment made under paragraph 21(a) will not necessarily be a dollar amount, so it would be impossible, in some cases, to compare the result of paragraph 21(a) to the fair value of the assets exchanged in the transaction.

Mr. Johnson stated that another problem was the phrase *portion of the reporting entity's operations*, in paragraph 21(b) of the proposed requirements. He stated that many respondents to the Exposure Draft questioned what was meant by the term *portion of the entity*. Mr. Johnson stated that the Board's intention was to require that any effects of the exchange should be considered in the analysis and recommended that paragraph 21 be clarified. The revised paragraph will read as follows:

> 21. To determine whether a nonmonetary exchange has commercial substance, the entity determines whether its future cash flows* are expected to change as a result of the exchange. A transaction has commercial substance if either:
>
> a. The configuration (risk, timing, or amount) of the expected future cash flows of the asset(s) received differs significantly from the configuration of the expected future cash flows of the asset(s) transferred, or
>
> b. The entity-specific value* of the asset(s) received differs from the entity-specific value of the asset(s) transferred, and the difference is significant in relation to the fair value of the assets exchanged.
>
> *Calculation of expected future cash flows and entity-specific value is discussed in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*.

Mr. Johnson stated that the staff of the IASB agrees with the above revision. He also stated that he would be talking to staff of the Canadian Accounting Standards Board after the meeting to gather their views on the issue. All Board members agreed with the staff recommendation pending further editorial changes.

Ms. McKenna stated that some constituents requested that examples of nonmonetary exchange transactions be included in the final Statement. She recommended that the Board not include examples in the final Statement because constituents may infer rules from those examples, and including examples may result in inconsistent application of Opinion 29 related to IAS 16.

Ms. Seidman stated that one area she believes is not clear to constituents is when to use entity-specific value. She suggested that the term *entity-specific value* as it is intended in the proposed Statement should be clarified in the basis for conclusions. That clarification could be in the form of a narrative example that shows how entity-specific value is used to evaluate whether commercial substance exists, but it is not used to record the fair value of the assets exchanged.

Three Board members stated that in some cases, they believe it is helpful to include examples in our standards, but in this particular case, no Board members objected to the staff recommendation to not include examples in the final Statement. Ms. Schipper stated that paragraph 21, as revised based on today's decisions, clearly states how a practitioner should evaluate whether commercial substance exists. She further explained that the concepts involved, including the risk, timing, and amount of expected future cash flows and entity-specific value, are not new and are well understood. Therefore, she believes examples are not necessary.

Ms. McKenna stated that the next issue is whether to change the requirement that 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. She recommended that the Board affirm its earlier decision on this matter. Ms. Seidman asked why the exact words of IAS 16 were not used in the Exposure Draft. Mr. Johnson responded that the U.S. tax code is different from the tax codes of other countries and therefore the exact wording could not be used. Therefore, the language in the Exposure Draft represents language agreed to by the SEC, the IASB, and the FASB. Ms. Schipper stated that she believes the basis for conclusions explains this issue appropriately because it points out the circularity of reasoning that the Board addresses with this provision. All Board members agreed with the staff recommendation pending potential nonsubstantive editorial changes.

Ms. McKenna stated that the staff also received a number of comments related to the scope of the document. She stated that some respondents suggested modifying the scope of the proposed Statement. She recommended that the scope be finalized as proposed because there was no new information obtained through the comment letter process that necessitates revisiting the scope. She also recommended inserting the term *significant* into revised paragraph 3(c) of Opinion 29 so that it reads:

> A transfer of a nonmonetary asset is not considered an exchange unless the transferor has no *significant* continuing involvement in the transferred asset such that *substantially all* the risks and rewards of ownership of the asset are transferred.

She stated that this change is necessary to clarify that the criteria used for nonmonetary asset exchanges is consistent with the criteria used for monetary asset exchange. She also stated that this change would address the issue that constituents raised regarding the proposed amendment of Statement 140, which would eliminate the scope exception for exchanges of equity method investments for similar productive assets in Statement 140. All Board members agreed with the staff recommendation.

Ms. McKenna recommended that the final Statement not require disclosure of the circumstances and reasons for nonmonetary exchanges. Mr. Johnson stated that such a requirement would be unduly burdensome on entities that have frequent nonmonetary exchanges, and he also stated that this requirement would be more of a presentation of audit evidence rather than financial reporting. All Board members agreed.

Ms. McKenna recommended that the Board affirm its decision that the provisions of the final Statement will be effective on a prospective basis for nonmonetary asset exchanges in fiscal years beginning after December 15, 2004, because the staff did not receive significant input from comment letter respondents. All Board members agreed.

Follow-up Items:

The staff was instructed to discuss with the staff of the IASB their reasoning for the inclusion of the following sentence in paragraph 24 of IAS 16:

> The acquired item is measured in this way even if an entity cannot immediately derecognize the asset given up within paragraph 24 of IAS 16.

In addition, the staff was asked to encourage the Technical Issues Committee of the AICPA to communicate the guidance of this Statement to small practitioners.

General Announcements:

None.