N1 Nonmonetary transactions

This chapter was last updated September 2014.

N1.1 Introduction

Most business transactions involve exchanges of cash or other monetary assets or liabilities. The amount of monetary assets or liabilities exchanged generally provides a basis for measuring the cost of nonmonetary assets or services received, as well as for measuring the gain or loss on nonmonetary assets transferred. Some transactions, however, involve either (a) an exchange with another entity that involves principally nonmonetary assets or liabilities or (b) a transfer of nonmonetary assets for which no assets are received or given up in exchange (nonreciprocal transfer). Both exchanges and nonreciprocal transfers that involve little or no monetary assets or liabilities are referred to in this section as nonmonetary transactions. Accounting for nonmonetary transactions is primarily addressed in ASC 845 *Nonmonetary Transactions*.

Examples of nonmonetary transactions listed in ASC 845-10-05-06 include the following:

- Exchange of product held for sale in the ordinary course of business (inventory) for other property as a means of selling a product to a customer
- Exchange of product held for sale in the ordinary course of business (inventory) for similar product as an accommodation — that is, at least one party to the exchange reduces transportation costs, meets immediate inventory needs, or otherwise reduces costs or facilitates ultimate sale of the product — and not as a means of selling the product to a customer (see Section N1.3.2)

Exchange of productive assets — assets employed in production rather than held for sale in the ordinary course of business, such as trades of player contracts by professional sports organizations, exchanges of leases on mineral properties, exchanges of interests in oil-producing properties, or exchanges of real estate for real estate (see Section N1.2)

N1.1.1 Consequential amendments from ASU 2014-09, *Revenue from Contracts with Customers*

In May 2014, the FASB and the International Accounting Standards Board issued ASU 2014-09, *Revenue from Contracts with Customers,* which replaces most existing revenue guidance and interpretations. ASU 2014-09 includes the following consequential amendments that will affect the accounting for nonmonetary transactions:

- The new revenue standard (ASC 606 *Revenue from Contracts with Customers*) applies when a contract with a customer includes noncash consideration (including barter credits). Consequently, such transactions generally would be outside the scope of ASC 845. However, if the exchange is between entities in the same line of business to facilitate sales to customers or potential customers, or the exchange lacks commercial substance, the transaction is in the scope of ASC 845.
- The FASB created ASC 610-20 *Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets*, which provides the accounting for gains and losses upon derecognition of nonfinancial assets that are within the scope of ASC 350 *Intangibles — Goodwill and Other* or ASC 360 *Property, Plant and Equipment*. ASC 610-20 uses the same principles that are in the new revenue standard. Contracts that are within the scope of ASC 610-20 are outside the scope of ASC 845.
- Industry-specific guidance for certain real estate transactions (including those involving a monetary and nonmonetary component) and exchanges of software was removed from ASC 845. Such transactions will be accounted for under ASC 606 or ASC 610-20, as applicable.
- ASC 845 will continue to exclude from its scope the deconsolidation of a subsidiary or a group of assets that is a business. However, certain transactions that were previously accounted for under the deconsolidation and derecognition guidance in ASC 810 *Consolidation* will be accounted for following the principles in the new revenue guidance.

- An entity will not be explicitly required to disclose gross operating revenues recognized from nonmonetary transactions. However, an entity should consider whether such disclosure is necessary to meet the objective in ASC 606-10-50-5, which requires an entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

- Other amendments reflect changes in the location of certain guidance (e.g., involuntary conversions).

ASU 2014-09 is effective for public entities for annual periods beginning after 15 December 2016, and interim periods within those annual periods, and for nonpublic entities for annual periods beginning after 15 December 2017, and interim and annual periods thereafter. Nonpublic entities are permitted to early adopt, but not earlier than the effective date for public entities.

Readers should carefully review this new guidance. See our Techline publications, *A closer look at the new revenue recognition standard* and *New revenue standard affects more than just revenue* for more information. Section N1 does not reflect the effects of these consequential amendments.

N1.2 Scope of ASC 845

ASC 845 includes the following definitions:

- Monetary assets and liabilities — Assets and liabilities whose amounts are fixed in terms of units of currency by contract or otherwise (e.g., cash, short- or long-term accounts and notes receivable in cash, and short- or long-term accounts and notes payable in cash).

- Nonmonetary assets and liabilities — Assets and liabilities other than monetary ones (e.g., inventories; investments in common stocks; property, plant, and equipment; and liabilities for rent collected in advance). In addition, nonmonetary exchanges also may include services to be performed or received.

It should be noted that the terms "financial assets" and "monetary assets" are not synonymous. For example, an investment in common stock is a financial asset but is not a monetary asset.

ASC 845 applies to all entities. However, the guidance in ASC 845 does not apply to the following transactions:

a. A business combination accounted for by an entity according to the provisions of ASC 805 *Business Combinations* or a combination accounted for by a not-for-profit entity according to the provisions of ASC 958-805 *Not-for-Profit Entities — Business Combinations* (see our Financial Reporting Developments publication (FRD), *Business combinations,* for guidance)

b. A transfer of nonmonetary assets solely between entities or persons under common control, such as between a parent and its subsidiaries or between two subsidiary corporations of the same parent, or between a corporate joint venture and its owners (see Appendix C of our FRD, *Business combinations,* for guidance on common control transactions and our FRD, *Joint ventures*, for guidance on identifying a joint venture)

c. An acquisition of nonmonetary assets or services upon issuance of the capital stock of an entity covered by ASC 718-10 *Compensation — Stock Compensation* or ASC 505-50 *Equity — Equity-Based Payments to Non-Employees* (see our FRD, *Share-based payment,* for guidance)

d. Stock issued or received in stock dividends and stock splits that are accounted for under ASC 505-20 *Equity, Stock Dividends and Stock Splits*

e. A transfer of assets to an entity in exchange for an equity interest in that entity (except for certain exchanges of a nonfinancial asset for a noncontrolling ownership interest — refer to Section N1.9)

f. 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, as described in ASC 932-360-40-7 *Extractive Activities — Oil and Gas Property, Plant, and Equipment, Derecognition*

g. An exchange of a part of an operating interest owned for a part of an operating interest owned by another party that is subject to ASC 932-360-55-6

h. A transfer of a financial asset within the scope of ASC 860-10-15 *Transfers and Servicing* (see our FRD, *Transfers and servicing of financial assets*, for guidance)

i. An involuntary conversion as specified in ASC 605-40-15-2 *Revenue Recognition, Gains and Losses, Scope and Scope Exceptions* (see Section C.3.1.3.1.1 of the Accounting Manual)

In addition, certain Subtopics within ASC 845 have scope exceptions, as listed in the relevant sections of this Accounting Manual.

ASC 845 describes nonmonetary transactions as exchanges and nonreciprocal transfers that involve little or no monetary assets or liabilities. This guidance acknowledges that some exchanges involve a small amount of monetary consideration, referred to as "boot," even though the exchange is essentially nonmonetary. ASC 845 also applies to these transactions (see Section N1.4). ASC 845 does not apply to transactions in which the monetary consideration is significant.

N1.3 Exceptions to fair value accounting for nonmonetary transactions

ASC 845 states that a reciprocal transfer of a nonmonetary asset is deemed an exchange only if the transferor has no substantial continuing involvement in the transferred asset such that the usual risks and rewards of ownership of the asset are transferred.

In general, the accounting for a nonmonetary transaction is based on the fair values of the assets exchanged. Thus, the cost of a nonmonetary asset received in exchange for another nonmonetary asset ordinarily is measured based on the fair value of the asset given up or, if more clearly evident, the fair value of the asset received. A gain or loss is recognized if the cost of the nonmonetary asset recognized differs from the carrying amount of the nonmonetary asset given up. If one of the parties in a nonmonetary transaction could have chosen to receive cash instead of the nonmonetary asset, that may provide evidence of the fair value of the nonmonetary assets exchanged. ASC 845-10-30-3 provides the following three exceptions to the general principle of accounting for nonmonetary transactions at fair value:

1. When neither the fair value of the nonmonetary asset received nor the fair value of the nonmonetary asset given up can be determined within reasonable limits

2. When 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 involved in the exchange

3. When the transaction lacks commercial substance

In each of the three exceptions, the accounting for the transaction is based on the carrying amount of the asset given up (after reduction for impairment, if applicable), which results in no gain or loss recognition. These three exceptions are discussed in Sections N1.3.1 — N1.3.3.

A difference between the gain or loss recognized for income tax purposes and the gain or loss recognized for accounting purposes may result in a temporary difference under ASC 740 *Income Taxes*. See our FRD, *Income taxes*, for guidance.

N1.3.1 Exception one — unable to determine fair value

ASC 820 *Fair Value Measurement* provides a framework for measuring fair value. Under ASC 820, the fair value of a nonmonetary asset(s) exchanged is based on the price that would be received to sell the asset(s) in an orderly transaction between market participants at the measurement date. Additional guidance about measuring fair value is included in our FRD, *Fair value measurement*.

The guidance in ASC 820, however, does not eliminate the practicability exception in ASC 845 if the fair value of the assets exchanged is not determinable within reasonable limits. Fair value would not be considered determinable within reasonable limits if major uncertainties exist about the realizability of the value that would be assigned to an asset received in a nonmonetary transaction accounted for at fair value. ASC 845-10-30-8 states that an exchange involving parties with essentially opposing interests is not considered a prerequisite to determining the fair value of a nonmonetary asset transferred. However, an exchange in and of itself does not ensure that a fair value for accounting purposes can be determined within reasonable limits.

Generally, we believe it would be rare that neither the fair value of the nonmonetary asset given up, nor the fair value of the nonmonetary asset received, can be determined within reasonable limits. However, judgment should be applied, based on the particular facts and circumstances.

If management determines that neither the fair value of the nonmonetary asset given up nor the fair value of the nonmonetary asset received can be determined within reasonable limits, the transaction is recorded at the carrying amount of the asset given up, which results in no gain or loss recognition.

N1.3.2 Exception two — exchange transaction to facilitate sales to customers

Often, entities exchange a product or property held for sale in the ordinary course of business for a similar product or property to facilitate sales to customers other than the parties to the exchange.

Such nonmonetary transactions will be recorded at carrying value (rather than fair value) if the product or property received will be sold in the same line of business as the product or property given up. In many cases, professional judgment will be required in determining whether the nonmonetary exchange involves products or properties to be sold in the same line of business. The general principle behind this exception to fair value is that profit is not recognized until the product or property is sold to the ultimate end user and there is a culmination of the earnings process.

In addition, ASC 845-10-30-15 through 30-16 provides guidance on the application of this principle to purchases and sales of inventory with the same counterparty in the same line of business, which is summarized in the following table:

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="3">Asset received</th></tr>
<tr><th>Raw materials</th><th>Work in process</th><th>Finished goods</th></tr>
<tr><th rowspan="3">Asset given up</th><th>Raw materials</th><td colspan="3" rowspan="2">Carrying amount</td></tr>
<tr><th>Work in process</th></tr>
<tr><th>Finished goods</th><td colspan="2">Fair value
(unless the other exceptions are met*)</td><td>Carrying amount</td></tr>
</table>

* Exchanges of finished goods inventory for raw materials or work in process inventory within the same line of business is not an exchange transaction to facilitate sales to customers. As a result, these transactions are recorded at fair value, unless the fair value is not determinable or the transaction lacks commercial substance, in which case, carrying amount is used.

N1.3.3 Exception three — exchange that lacks commercial substance

Under ASC 845-10-30-4, commercial substance exists if the entity's future cash flows are expected to significantly change as a result of the exchange. The entity's future cash flows are expected to significantly change if either of the following criteria is met:

a. The configuration of the future cash flows of the asset(s) received differs significantly from the configuration of the future cash flows of the asset(s) transferred. The configuration of the future cash flows is comprised of the risk, timing and amount of the cash flows. A change in any one of those elements would be considered a change in the configuration. Professional judgment is required in determining whether there has been a significant change in the configuration of the future cash flows, particularly when determining if the risk or timing of future cash flows differs. Examples of significant changes in the risk of future cash flows include changes in counterparty credit worthiness or changes in the actual or imputed interest rate. Also, in determining whether there has been a significant change in the timing of future cash flows between the assets exchanged, the period over which the future cash flows are expected to occur for the asset received is compared to that of the asset given up.

b. The entity-specific value of the asset(s) received differs from the entity-specific value of the asset(s) given up, and the difference is significant in relation to the fair values of the assets exchanged. When entity-specific value is determined, entity-specific assumptions for the use of the assets exchanged are substituted for the assumptions of a marketplace participant. For example, if an entity anticipates using a piece of equipment for three years even if the equipment is anticipated to have value in the marketplace for ten years, the entity-specific value is based on the three-year life.

Professional judgment is required in determining whether a change in the configuration of the future cash flows is significant. While there are no quantitative bright lines to assess the significance of a change in future cash flows, we believe a change in future cash flows of less than 5% generally will not be considered significant, while a change of more than 20% generally will be considered significant. Determining whether a change in future cash flows between 5% and 20% is significant will require the exercise of professional judgment based on the particular facts and circumstances.

Regardless of the quantitative assessment, a qualitative assessment of the substance of the exchange should be performed. In some cases, a qualitative assessment will be conclusive in determining whether the exchange has commercial substance. For example, an entity may determine that an asset received in an exchange will significantly reduce the production time for an existing product or provide the entity with new technology that can be used to enhance an existing product. Such a significant change to the entity's business may result in management concluding that the exchange has commercial substance without performing a quantitative assessment of the expected change in cash flows. The qualitative assessment also may be conclusive when the nature of the assets exchanged is substantively different (e.g., an exchange of an asset for a noncontrolling interest in a business).

In the United States and in some other tax jurisdictions, a transaction is not given effect for tax purposes unless it serves a legitimate business purpose other than tax avoidance. Consequently, tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result should not be considered in the evaluation of commercial substance. That is, the assessment of commercial substance cannot be based on the tax consequences of the exchange alone.

N1.3.4 Assessing whether the exceptions to fair value apply to various examples

The following four examples illustrate whether the exceptions to the general principle of accounting for nonmonetary transactions at fair value are applicable:

Illustration N1-1: Autos for autos

An automobile dealer exchanges new models with another dealer to obtain the particular color or model ordered by a customer. This exchange is intended to facilitate a sale to a customer who is not a party to the exchange and involves inventory held for sale in the same line of business. Thus, this transaction is measured based on the carrying amount of the autos given up in the exchange and no gain or loss is recognized on the transaction.

Illustration N1-2: Office equipment for autos

An office supply retailer provides office equipment and supplies to an automobile dealer in exchange for an automobile. The automobile dealer will use the office equipment and supplies in its financing department. The new equipment is an upgrade from the automobile dealer's old equipment and will allow the automobile dealer to reduce administrative expenses. The office supply retailer will use the car received in its repair department, allowing the department to reduce response times and meet service level commitments. Although the exchange involves products held for sale by each entity, the transaction is not an exchange of a product held for sale in the ordinary course of business for a product to be sold in the same line of business to facilitate sales to customers. Additionally, the exchange appears to have commercial substance. Since both parties are in the business of selling the assets they are giving up in the transaction, fair value can easily be determined and the exchange is accounted for by each party at the fair value of the asset given up, or, if it is more clearly evident, at the fair value of the asset received.

Illustration N1-3: Truck for van

An entity that maintains a fleet of vehicles for deliveries exchanges a truck for a van with another entity. Both vehicles have the same estimated remaining useful life. The new van will serve the same purpose as the truck given up, which is to make deliveries. The exchange was made because the entity's delivery drivers prefer using vans during bad weather so they do not have to cover and uncover the products being delivered. However, the exchange will not affect the number of deliveries made by the entity or the wages paid to delivery drivers. The risk, timing, and amount of cash flows and the entity-specific value associated with each vehicle are not expected to be significantly different. Therefore, the exchange lacks commercial substance from the perspective of the entity that gave up the truck and is measured by that entity based on the carrying amount of the truck given up.

The entity that gave up the van would separately evaluate whether the exchange has commercial substance from its perspective.

Illustration N1-4: Machinery for machinery
A manufacturer exchanges a piece of manufacturing equipment for equipment that will allow the entity to offer new features on its current product. Both machines have the same estimated remaining useful life and fair value, and the future maintenance on the equipment is expected to be comparable. Although the fair value of the two machines is the same, the entity-specific value is significantly different. The new machine allows the entity to improve its current product. As such, the transaction is accounted for at fair value.

N1.4 Relative amount of monetary consideration

Some exchanges of nonmonetary assets include a small amount of monetary consideration, which is often referred to as "boot." If the monetary consideration is significant to the transaction, the exchange of nonmonetary assets is considered monetary, the guidance in ASC 845 is not applicable and other guidance would apply. Under ASC 845, the monetary consideration is considered to be significant if it represents at least 25% of the fair value of the exchange. However, if the monetary consideration is less than 25% of the fair value of the exchange, the transaction is considered nonmonetary.

Special guidance exists for the exchange of real estate when the monetary consideration is at least 25% of the fair value of the exchange. For further information on such transactions, see Section 1.6.1 in our FRD, *Real estate sales*.

When the amount of monetary consideration is less than 25% of the fair value of the exchange, the transaction is considered nonmonetary and is recorded at fair value unless the transaction meets one of the exceptions to fair value in Section N1.3. If one of the exceptions to fair value is met, entities should follow the guidance in ASC 845-10-30-6:

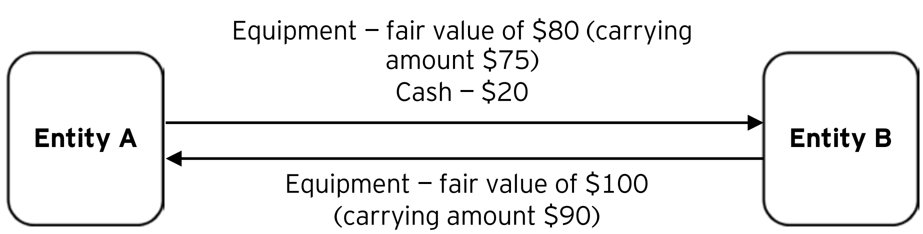
- The receiver of the boot records a gain on the exchange to the extent the cash consideration received exceeds a proportionate share of the carrying amount of the asset given up. The portion of the cost related to the realized amount is based on the ratio of the monetary consideration to the total consideration received (monetary consideration plus the estimated fair value of the nonmonetary asset received) or, if more clearly evident, the fair value of the nonmonetary asset given up.
- The payer of boot would not recognize a gain, but would record the asset received at the carrying amount of the asset given up plus the monetary consideration paid.

If a loss is indicated by the terms of the transaction, the entire loss on the exchange is recognized.

Illustration N1-5: Recognizing a gain in a transaction recorded at carrying amount with boot

Fact pattern

Entity A and Entity B are both in the same line of business of selling manufacturing equipment. They enter an agreement in which Entity A gives up manufacturing equipment with a fair value of $80 and cash of $20 in exchange for manufacturing equipment from Entity B with a fair value of $100. The carrying amount of the manufacturing equipment given up by Entity A is $75. The carrying amount of the manufacturing equipment given up by Entity B is $90.



Analysis

Because the boot is less than 25% of the fair value of the exchange (20%, or $20/$100), the monetary consideration is not significant and therefore, the transaction is a nonmonetary exchange. However, because Entity A and B are exchanging finished goods for finished goods in the same line of business, the transaction is measured at carrying amount (see Section N1.3.2). Entity A would record the following journal entry:

Dr. Manufacturing equipment received ($20 + $75)	95	
Cr. Cash		20
Cr. Manufacturing equipment given up		75

Entity A recognizes the manufacturing equipment received for $95, which is the sum of the carrying amount of the asset given up of $75, plus the cash "boot" paid of $20.

Entity B would record the following journal entry:

Dr. Manufacturing equipment (received) ($90 + $2 − $20)	72	
Dr. Cash	20	
Cr. Gain [$20 − ($20/$100)*$90)]		2
Cr. Manufacturing equipment (given up)		90

Entity B recognizes the manufacturing equipment received for $72, which is the sum of the carrying amount of the asset given up of $90 and the realized gain of $2, less the cash received of $20. The gain of $2 is calculated as the excess of the cash received of $20 over the realized portion of the cost basis, which is $18, or 20% of the carrying amount of $90 (20% being the ratio of the cash ($20) to the total fair value of the consideration received ($100)).

N1.4.1 Transactions involving contingent consideration

Some transactions involving nonmonetary assets and liabilities may include contingent consideration payable in cash (i.e., consideration transferred to the counterparty if certain events occur or conditions are met). Parties commonly use these arrangements when they cannot reach agreement on the value of the consideration being exchanged. These contingencies frequently are based on earnings or instrument price changes over specified periods after the transaction occurs; however, they might be based on other factors. Examples of such contingencies include:

- Earnings greater than an agreed-upon target over a period
- Components of earnings (e.g., revenue, EBITDA) greater than an agreed-upon target over a period
- The attainment of product development milestones
- Approval of a patent, license, drug, etc.
- Cash flows arising from specified assets over an agreed period

When a nonmonetary exchange includes contingent consideration payable in cash, questions arise in practice as to whether the contingent consideration arrangement should be considered in determining whether the transaction falls within the scope of ASC 845. Because contingent consideration is a way of financing the transaction price, we believe it is similar to the issuance of a note receivable or payable. Thus, we believe contingent consideration payable in cash is a monetary asset or liability that should be evaluated for its significance to the transaction. For example, if the fair value of the contingent consideration (and any up-front cash exchanged) is more than 25% of the fair value of the exchange, then the exchange is not within the scope of ASC 845. For guidance on measuring the fair value of a contingent consideration arrangement, see our FRD, *Fair value measurement*, and Section 6.4.4 of our FRD, *Business combinations*.

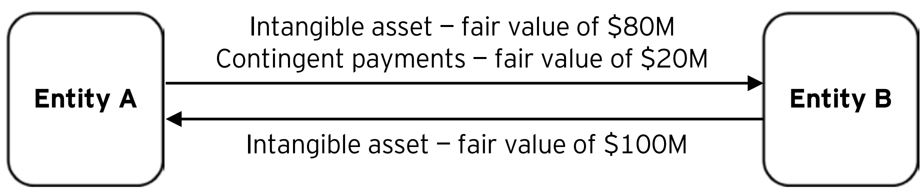
Illustration N1-6: Evaluation of the significance of a consideration arrangement in a nonmonetary transaction

Fact pattern

Entity A and Entity B enter an agreement in which Entity A gives up an intangible asset with a fair value of $80 million in exchange for an intangible asset from Entity B with a fair value of $100 million. In addition, Entity A will pay the following amounts to Entity B if certain milestone events occur:

Milestone	**Amount**
Milestone #1	$ 1,000,000
Milestone #2	3,000,000
Milestone #3	6,000,000
Milestone #4	10,000,000
Milestone #5	15,000,000
Milestone #6	15,000,000
Milestone #7	10,000,000
Total due (if all milestones are met)	$ 60,000,000

Entity A determines that the fair value of the contingent consideration payable is $20 million (or 20% [$20 million / $100 million] of the fair value of the exchange) using a probability-weighted discounted cash flow method.



Analysis

Because the contingent consideration payable is less than 25% of the fair value of the exchange, the monetary consideration is not significant and, therefore, the transaction is a nonmonetary exchange.

N1.4.2 Monetary assets transferred by both parties

Some transactions involving nonmonetary assets and liabilities may require both parties to transfer monetary consideration. When determining whether the monetary consideration is significant (that is, more than 25% of the total fair value of the exchange), questions arise in practice as to whether the monetary consideration should be evaluated on a gross or a net basis. Under the "gross" basis, the amount of monetary consideration transferred by one party is compared to the fair value of the total consideration given by that party (including the gross amount of monetary consideration). Under the "net" basis, the net amount of monetary consideration transferred or received by one party (i.e., the monetary consideration transferred less the monetary consideration received) is compared to the fair value of the total consideration given by that party (including the net amount of monetary consideration transferred or received).

Because ASC 845 does not address this situation, entities will need to exercise judgment, considering the particular facts and circumstances. In reaching a conclusion, entities may want to consider the following factors (we do not believe any of the factors taken individually is determinative nor is the list all-inclusive):

	Indicative of net evaluation	Indicative of gross evaluation
Credit risk	One or both parties may reduce their payments for the non-payment by the other party	Each party is subject to the credit risk of the other party (i.e., the risk that the other party will default on its payments)
Nature of events triggering payment	▸ Certain to occur (i.e., fixed dates) ▸ Similar or dependent events	▸ One or both events are not certain of occurring ▸ Independent events (i.e., one party might have to pay while the other does not)
Intended settlement method	Parties intend to offset their payments	Parties intend to collect/receive amounts on a gross basis
Contractual terms	▸ The entity has the right to set off the amount owed with the amount owed by the other party ▸ The right of setoff is enforceable at law	▸ The entity does not have the right to set off the amount owed with the amount owed by the other party ▸ The right of setoff is not enforceable

Also, depending on the facts and circumstances, entities may want to consider the guidance in ASC 845 on whether inventory purchases and sales were entered into in contemplation of one another (see Section N1.6). Finally, entities also may want to consider the guidance in ASC 605-45-45 *Revenue Recognition, Principle-Agent Considerations, Other Presentation Matters* for evaluating whether the entity is a principal or an agent in assessing whether the entity should report revenue gross or net.

N1.5 Substance of the transaction

Sometimes a transaction (or transactions) is structured according to a specific form that is different from its substance in order to achieve a desired tax result or some other purpose. In addition, there are cases in which contemporaneous or nearly contemporaneous sales of assets are presumed to be exchanges of those assets and, therefore, covered by the provisions of ASC 845 (i.e., a nonmonetary transaction). Some arrangements also may include multiple transactions (e.g., an exchange of assets and then a distribution to owners). To assess whether the multiple transactions should be accounted for as separate transactions or as a single transaction, we believe companies should consider the factors in ASC 810-10-40-6, which apply to situations when a parent ceases to have a controlling interest in a subsidiary through two or more arrangements. See Section 6.1.6 of our FRD, Consolidated and other financial statements, for guidance.

In addition, ASC 845 gives factors for evaluating whether inventory purchase and sale transactions should be combined into a single transaction (see Section N1.6). These factors also may be considered when evaluating whether two (or more) transactions should be treated as a single transaction in other nonmonetary exchanges.

Entities will need to exercise judgment, considering the facts and circumstances, to determine the substance of the transaction(s). Such a determination should be documented clearly and contemporaneously.

The following are two examples of situations in which contemporaneous or nearly contemporaneous sales of assets for monetary consideration are considered a single nonmonetary transaction:

Illustration N1-7: Contemporaneous purchase/sale transactions

Fact pattern

Entity A and Entity B are in the business of selling undeveloped parcels of land and each own a piece of undeveloped land zoned for residential use (Properties 1 and 2, respectively). Entity A and Entity B enter into the following transactions:

- Entity A sells Property 1, which has a carrying amount of $8 million, to Entity B for $13 million in cash (the fair value of the property).
- Three days later, Entity B sells Property 2, which has a carrying amount of $12 million, to Entity A for $16 million in cash (also the fair value of that property).

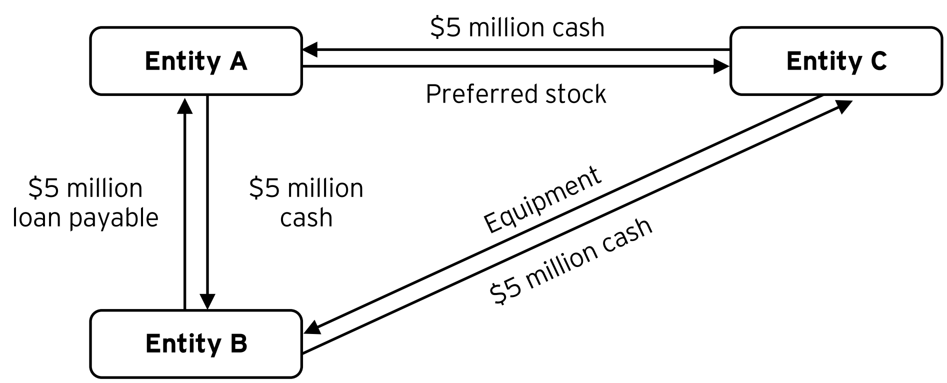
Analysis

Although these two transactions were not contemporaneous, the substance of the transactions appears to be a contemporaneous exchange and the transactions are evaluated together in accordance with ASC 845. In substance, Entity A exchanged real estate for real estate and paid $3 million in cash to Entity B. Similarly, Entity B exchanged real estate for real estate and received $3 million in cash from Entity A. Because this transaction involves some monetary consideration and appears to be an exchange of property held for sale in the ordinary course of business for property to be sold in the same line of business to facilitate sales to customers, the transaction is accounted for in accordance with ASC 845. Refer to Section N1.6 for additional information on applying this guidance.

Illustration N1-8: Contemporaneous purchase of assets and sale of stock

Fact pattern

Entity A advances $5 million to Entity B (an entity under common control with Entity A), which uses the funds to acquire equipment from unrelated Entity C. The carrying amount of the equipment is $2 million on Entity C's books. On the same day, Entity C purchases preferred stock of Entity A for $5 million. Entity C accounts for the preferred stock as a cost method investment.



Analysis

In substance, these transactions represent a single nonmonetary exchange of equipment for preferred stock. In accordance with ASC 845, Entity C would apply the guidance in Section N1.9.5 and record its cost method investment in Entity A at the fair value of the equipment given up. Entity C would recognize a gain or loss for the difference between the fair value of the asset recorded and the carrying amount of the equipment given up. Entity C should not assume that the $5 million cash paid to receive the preferred stock represents the fair value of the equipment exchanged because neither entity has actually contributed any cash in the combined transaction. We believe it would be rare that the fair value of equipment could not be determined within reasonable limits. However, if neither the fair value of the equipment given up nor the fair value of the preferred stock received can be determined within reasonable limits, Entity C would record its investment in Entity A based on the carrying amount of the equipment given up ($2 million) and no gain would be recognized.

ASC 845 specifically excludes acquisitions of nonmonetary assets through issuance of an entity's own stock from its scope. Therefore, Entity A applies the guidance for equity-based compensation to non-employees in ASC 718-10 and ASC 505-50. Refer to Section 9 in our FRD, *Share-based payment*, for additional guidance.

N1.5.1 "Like-kind" exchanges

Entities may enter into "like-kind" exchanges to obtain favorable treatment under Internal Revenue Code Section 1031 whereby the tax basis of the asset received is considered to be the same as the tax basis of the asset given up.

In some cases, these exchanges may involve three unrelated parties, in which the parties contribute or receive monetary or nonmonetary assets through an escrow account. We do not believe such transactions qualify as a nonmonetary exchange within the scope of ASC 845, and other GAAP would apply. In substance, the transaction consists of two monetary transactions (the sale of an asset to one party for monetary consideration followed by the purchase of another asset for monetary consideration from a different party). The following example illustrates this fact pattern.

Illustration N1-9: Like-kind exchanges involving three parties

Fact Pattern

Entity A sells property to Entity B for cash, which is placed into an escrow account. In accordance with Entity A's instructions, Entity B uses the cash in the escrow account to purchase another piece of property from Entity C. Entity A takes title to the property that Entity B purchased from Entity C.

Analysis

Even though Entity A did not pay or receive monetary consideration, this transaction does not qualify as a nonmonetary transaction within the scope of ASC 845. As a result, Entity A records the sale of property in accordance with ASC 360-20 *Property, Plant, and Equipment — Real Estate Sales*. Depending on whether the acquired property meets the definition of a business, Entity A would apply either ASC 805 or asset acquisition accounting for the purchase of the property from Entity C.

N1.6 Purchases and sales of inventory with the same counterparty

Section N1.5 discusses situations in which contemporaneous or nearly contemporaneous sales of assets are presumed to be exchanges of those assets and, therefore, covered by the provisions of ASC 845. ASC 845 also addresses issues specific to inventory purchase and sale transactions, including whether purchases and sales of inventory from the same counterparty are combined when applying ASC 845 and whether exchanges of inventory within the same line of business are accounted for at fair value or at the inventory's carrying amount. See Section N1.3.2 for guidance on whether purchases and sales of inventory from the same counterparty are recognized at fair value or at its carrying amount. However, ASC 845 does not apply to inventory purchase and sale arrangements that are accounted for as derivatives under ASC 815 *Derivatives and Hedging* or that involve exchanges of software or exchanges of real estate.

Inventory purchase and sale transactions with the same counterparty are combined when applying ASC 845 if the transactions were entered into in contemplation of one another. For example, ASC 845 clarifies that if one inventory transaction is legally contingent on the performance of the other inventory transaction, the two transactions are deemed to have been entered into in contemplation of one another and, therefore, are combined when applying ASC 845. However, there may be situations in which the inventory transactions are not legally contingent on one another. In these situations, ASC 845-10-25-4 provides the following four factors, which may indicate that the inventory purchases and sales were entered into in contemplation of one another (none of the factors taken individually is determinative nor is this list all-inclusive):

1. *There is a specific legal right of offset of obligations between counterparties involved*. The ability to offset the payable(s) and receivable(s) related to the separately documented inventory purchase and sale transactions indicates that there is a link between them and, therefore, it is an indicator that the

separately documented inventory transactions were entered into in contemplation of one another. This indicator is more relevant to settlement provisions related to specifically identified inventory purchases and sales than to transactions netted as part of a master netting agreement that encompasses all transactions (inventory and non-inventory) between the two counterparties.

2. *Inventory purchase and sale transactions with the same counterparty are entered into simultaneously*. An inventory purchase transaction simultaneously entered into with an inventory sale transaction with the same counterparty would indicate that the transactions were entered into in contemplation of one another. However, the mere issuance of invoices and the exchange of offsetting cash payments is not a factor in determining whether the transactions were entered into in contemplation of one another.

3. *Inventory purchase and sale transactions were entered into at terms that were off-market when the arrangement was agreed to between the parties*. If an entity enters into an off-market inventory transaction with a counterparty, that is an indication that the transaction is linked to, and entered into, in contemplation of another inventory transaction with that same counterparty. This indicator is more relevant for transactions with products that have readily determinable market prices, such as exchange-traded commodities, than for transactions with products that are subject to greater discretionary pricing.

4. *Relative certainty that reciprocal inventory transactions with the same counterparty will occur*. An entity may sell inventory to a counterparty and enter into another arrangement with that same counterparty whereby that counterparty may, but is not contractually required to, deliver an agreed-upon inventory amount. If that counterparty chooses to deliver its product to the entity, the entity is obligated to purchase that product. The more certain it is that both inventory transactions will occur, the stronger the indication that the two inventory transactions were entered into in contemplation of one another.

The application of these factors depends on the particular facts and circumstances and requires the use of professional judgment. The issuance of invoices and the exchange of offsetting cash payments is not a factor in determining whether two or more inventory purchase and sales transactions with the same counterparty are considered as a single exchange transaction. See Section N1.4 and N1.4.2 for guidance regarding the extent of boot (that is net cash exchanged) that should be considered when determining whether the inventory purchase and sales transactions are monetary or nonmonetary in nature.

The guidance also does not address whether transactions measured at fair value qualify for revenue recognition. Rather, an entity applies the guidance in ASC 605 *Revenue Recognition* to determine whether (or when) the criteria for revenue recognition are met.

The following examples from ASC 845 illustrate whether the purchase and sale of inventory with the same counterparty is viewed as a single exchange transaction and whether the nonmonetary exchange of inventory within the same line of business is recognized at fair value.

Illustration N1-10: Sale and purchase of inventory between two oil entities

Oil Entity A produces heavy crude oil (dense, viscous crude oil) in California and has refining operations in other parts of the United States including West Texas. Given its supply-chain management needs, Entity A would like to acquire West Texas intermediate crude oil in the most cost-efficient manner.

As part of its analysis in determining the most cost-efficient approach to acquiring West Texas intermediate crude oil, Entity A uses the following available information regarding the current oil needs (demand) and excess oil capacity (supply) of the various oil entities.

Entity	Demand/Location	Supply/Location
Entity A	West Texas intermediate crude oil/Texas	Heavy crude oil/California
Entity B	Heavy crude oil/California	Sweet crude oil/Oklahoma
Entity C	Sweet crude oil/Oklahoma	West Texas intermediate crude oil/Texas

Entity A enters into an arrangement to sell Entity B a specified quantity of its California production and enters into a separate arrangement at the same time to purchase a specified quantity of Entity B's sweet crude oil production in Oklahoma. Also at the same time, Entity A enters into an arrangement to sell Entity C the sweet crude oil in Oklahoma purchased from Entity B, and enters into a separate arrangement at the same time to acquire a specified quantity and quality of West Texas intermediate crude oil from Entity C for its West Texas refining operations.

Entity A issues invoices and purchase orders for each transaction and each is gross-cash settled at market prices. Although the quantities differ, there is an insignificant difference in total value of oil being exchanged in each transaction. Entity A would not sell its inventory to Entity B or Entity C without an understanding that the counterparty will perform. Entity A considers all crude oil to be the same class of inventory (that is, raw materials) for purposes of financial reporting. Entity A does not account for these arrangements as derivatives; therefore, the guidance in ASC 815 is not applicable.

Based on an evaluation of the circumstances, Entity A's inventory purchase and sale transactions with Entity B were entered into in contemplation of one another because the sole purpose of selling inventory was to procure inventory from the same counterparty in the most cost-efficient manner. While it is a matter of judgment as to whether Entity A entered into its inventory purchase and sale transactions with Entity B in contemplation of one another, certain factors support this assessment. For instance, the transaction to sell inventory was entered into simultaneously with the transaction to purchase inventory. In addition, the sole purpose of selling heavy crude oil inventory is to facilitate the purchase of sweet crude oil inventory. Although the purpose of a transaction is not explicitly identified as an indicator, it is nevertheless relevant to the assessment of whether the inventory transactions were entered into in contemplation of one another. While the inventory transactions were not settled on a net basis nor were they entered into at off-market prices, the other indicators, together with the specific facts and circumstances described above, provide persuasive evidence that the transactions were entered into in contemplation of one another. Therefore, although each transaction was separately documented and gross-cash settled at market prices, the inventory transactions should be deemed a single exchange between Entity A and Entity B and accounted for under ASC 845. From the perspective of Entity A, an analysis of the inventory purchase and sale transactions between Entity A and Entity C would result in the same conclusion as the analysis of the transactions between Entity A and Entity B.

Entity A would recognize the single exchange transactions with both Entity B and Entity C at carryover basis because, from Entity A's perspective, the same class of inventory (raw materials for raw materials) was surrendered and received (see Section N1.3.2 for further information).

Illustration N1-11: Sale and purchase of inventory between auto dealers

Dealer A has an excess inventory of cars relative to near term expected demand and does not have enough pickup trucks to meet near term expected demand. Dealer B has an excess inventory of pickup trucks and not enough cars to meet near term expected demand. Dealer A negotiates an arrangement to sell a specified number of cars to Dealer B and, although not committed to do so, Dealer B may deliver pickup trucks of equivalent value at wholesale prices to Dealer A. Dealer A must purchase pickup trucks from Dealer B if Dealer B chooses to deliver the trucks the following week. Historically, Dealer B has always delivered the trucks to Dealer A under these types of arrangements. At the time Dealer A delivers its cars to Dealer B, Dealer A believes Dealer B will ship the trucks the following week. Each transaction will be separately documented and gross-cash settled at wholesale prices on the date of delivery.

Dealer A's inventory sale transaction was entered into in contemplation of a reciprocal inventory purchase transaction from Dealer B because, as a condition of selling inventory to Dealer B, Dealer A must accept delivery of trucks from Dealer B at a later date, if Dealer B chooses to make such a delivery. Consistent with past history, when Dealer A enters into this kind of arrangement with Dealer B, Dealer A fully expects to purchase the trucks. Therefore, the sale of the cars should be considered in combination with the purchase of the trucks. When evaluating the inventory transactions as a single nonmonetary exchange, Dealer A would recognize the transactions at carryover basis because the same class of inventory is being exchanged (finished goods exchanged for finished goods) (see Section N1.3.2 for further information).

However, if Dealer B chose not to deliver the trucks the following week, Dealer A should recognize the gain on the original transaction. If Dealer A enters into a similar arrangement with Dealer B in the future, Dealer A must consider Dealer B's past actions in assessing the likelihood of whether a reciprocal inventory purchase transaction from Dealer B will occur. Given Dealer B's decision to not deliver the trucks in the most recent transaction, it may not be appropriate to assume that the sale of cars to Dealer B was entered into in contemplation of a reciprocal inventory purchase transaction from Dealer B.

Illustration N1-12: Sale and purchase of inventory between two manufacturers

Manufacturer A has a longstanding business relationship with Manufacturer B, whereby each manufacturer will buy and sell inventory from one another on an as-needed basis at market prices. Manufacturer A sells materials to Manufacturer B based on a purchase order from Manufacturer B. Two days later, Manufacturer B sells materials to Manufacturer A based on a separate purchase order from Manufacturer A. Neither transaction was predicated on the occurrence of the other transaction occurring through either an implied arrangement or a contractual arrangement, and, historically, Manufacturer A has sold twice as much in value to Manufacturer B as Manufacturer B has sold to Manufacturer A. Both of these inventory transactions are gross-cash settled at market prices.

The inventory purchase and sale transactions were not entered into in contemplation of one another. Reciprocal inventory purchase and sale transactions were not negotiated between the two counterparties at the same time. In addition, there is no correlation between the value of goods delivered to Manufacturer B to the value of goods received from Manufacturer B. Therefore, the inventory purchase and sale transactions would not be deemed a single exchange by Manufacturer A or B for purposes of applying ASC 845 and would be considered separate monetary transactions subject to the guidance in other relevant generally accepted accounting principles.

N1.7 Impairment recognition when a nonmonetary asset is exchanged or distributed to owners and the transfer is accounted for based on the asset's recorded amount

ASC 845-10-30-3 indicates that when a nonmonetary exchange is accounted for based on its recorded (carrying) amount any indicated impairment should be recorded.

If the transaction involves the exchange of a long-lived asset for another long-lived asset or the distribution of a long-lived asset to owners of an entity, ASC 360-10-40-4 requires that the asset be tested for impairment (a) on a held-and-used basis prior to the disposal date based on its undiscounted cash flows and (b) at the disposal date based on its fair value. Refer to Section 3.2 in our FRD, *Impairment or disposal of long-lived assets,* for additional guidance.

If the transaction involves the exchange of a financial asset that is nonmonetary asset (e.g., investments in equity securities, or an equity method investment), the applicable guidance (e.g., ASC 320 *Investments — Debt and Equity Securities* or ASC 323 *Investments — Equity Method and Joint Ventures*, respectively) should be applied to determine whether declines in the fair value below the cost basis (i.e., impairments) are other-than-temporary. See Section 5 of our FRD, *Certain investments in debt and equity securities* and Section 5.8 of our FRD, *Equity method investments*, for guidance.

N1.8 Nonreciprocal transfers, including spin-offs

ASC 845 defines a nonreciprocal transfer as a transfer of assets or services in one direction, either from an entity to its owners (whether or not in exchange for their ownership interests) or from the entity to another entity, or from owners or another entity to the entity. Examples of nonreciprocal transactions include the distribution of marketable securities as dividends to the entity's shareholders, the pro-rata distribution of capital stock of a subsidiary to the entity's shareholders (i.e., a spin-off) or the reacquisition of outstanding stock.

The following table summarizes the accounting for nonreciprocal transfers to owners, which depends on whether (1) the assets distributed meet the definition of a business under ASC 805 and (2) the transfer is pro-rata. (Refer to our FRD, *Business combinations,* for guidance on determining whether the assets distributed constitute a business).

<table>
<tr><th colspan="2" rowspan="2">Assets distributed to owners</th><th colspan="2">Pro rata</th></tr>
<tr><th>Yes</th><th>No</th></tr>
<tr><td rowspan="3">Business</td><td>Shares of a consolidated subsidiary</td><td rowspan="2">Carrying amount
(Refer to S4 of the Accounting Manual)</td><td rowspan="2">Fair value
(Refer to S4 of the Accounting Manual)</td></tr>
<tr><td>Equity method investment</td></tr>
<tr><td>Nonmonetary assets</td><td>Carrying amount
(Refer to N1.8.1)</td><td>Fair value
(Refer to N1.8.1)</td></tr>
<tr><td rowspan="4">Not a business</td><td>Shares of a consolidated subsidiary</td><td colspan="2" rowspan="2">Fair value if criteria met, otherwise carrying amount
(Refer to S4.3 of the Accounting Manual)</td></tr>
<tr><td>Equity method investment</td></tr>
<tr><td>Nonmonetary assets</td><td colspan="2">Fair value if criteria met, otherwise carrying amount
(Refer to N1.8.1)</td></tr>
<tr><td>Other monetary assets (e.g., loans, receivables)</td><td colspan="2">Fair value
(Refer to N1.8.2)</td></tr>
</table>

See Section N1.8.4 for guidance on the accounting for nonreciprocal transfers to other than owners.

N1.8.1 Nonreciprocal transfers of nonmonetary assets

In accordance with ASC 845-10-30-10, a pro-rata nonreciprocal transfer of nonmonetary assets to owners in a spin-off or other form of reorganization or liquidation, or in a plan that is in substance the rescission of a prior business combination, is recognized at the carrying amount (after reduction for an indicated impairment, if necessary) of the nonmonetary assets transferred if the nonmonetary assets being distributed meet the definition of a business. See Section S4.3.1 of the Accounting Manual for guidance on determining whether a nonreciprocal transfer is pro-rata.

Other nonreciprocal transfers of nonmonetary assets to owners are accounted for at fair value and a gain or loss is recognized on the disposition of the asset if the fair value of the nonmonetary asset transferred is (1) objectively measurable and (2) clearly realizable to the transferor in an outright sale at or near the time of the distribution. We believe that the second condition is an anti-abuse provision that is designed to prevent entities from recognizing a gain or loss on the transfer of a nonmonetary asset to its owners that it could not otherwise recognize in an outright sale to third parties at or near the time of distribution.

If both criteria are not met, the nonreciprocal transfer would be accounted for at the carrying amount of the nonmonetary assets transferred (after reduction for an indicated impairment, if necessary), regardless of whether the transfer is on a pro-rata or non pro-rata basis. See Section 3.2 of our FRD, *Impairment or disposal of long-lived assets,* for guidance on measuring impairments.

ASC 845-10-30-1 states that a nonmonetary asset received in a nonreciprocal transfer is measured based on the fair value of the asset received.

N1.8.2 Nonreciprocal transfers of monetary assets

ASC 845-10-25-3 addresses situations in which an entity distributes loans receivable to its owners by forming a subsidiary, transferring those loans receivable to the subsidiary and then distributing the stock of that subsidiary to shareholders of the parent. Such transactions are considered dividends-in-kind. According to ASC 845-10-30-14, dividends-in-kind are initially measured at fair value by the entity and the recipient.

N1.8.3 Split-offs of certain nonmonetary assets to owners

A split-off is a transaction in which a parent entity exchanges its stock in a subsidiary for parent entity stock held by its shareholders. See Section S4 of the Accounting Manual for guidance on the accounting for split-offs.

N1.8.4 Nonreciprocal transfers to non-owners

Some nonreciprocal transfers are between an entity and entities other than its owners. Examples are the contribution of nonmonetary assets by an entity to a charitable organization or not-for-profit entity and the contribution of land by a governmental unit for construction of productive facilities by an entity. Refer to ASC 720-25 *Other Expenses — Contributions Made* for guidance on accounting for contributions given. See Section G1 of the Accounting Manual for guidance on nonreciprocal transfers received from a government.

N1.9 Exchanges involving investments in other entities, controlled assets and groups of assets

This section addresses several types of nonmonetary transactions involving investments in other entities, controlled assets and controlled groups of assets. In addition to the scope exceptions in ASC 845-10-15-4 (see Section N1.2), the guidance in the Exchanges of a Nonfinancial Asset for a Noncontrolling Ownership Interest Subsections of ASC 845 does not apply to the following transactions:

- Transfers between a joint venture and its owners (see our FRD, *Joint ventures,* for guidance)
- A capital contribution of real estate in return for an unconsolidated real estate investment, as described in ASC 970-323 *Investments — Equity Method and Joint Ventures [Real Estate]* (see Section RE1.6.2 in our FRD, *Real estate sales,* for guidance)
- A transfer of real estate in exchange for nonmonetary assets other than real estate (for guidance on the recognition of profit from the exchange, see ASC 360-20-40 and ASC 976-605 *Revenue Recognition [Real Estate — Retail Land]*)
- A deconsolidation of a subsidiary that is a business or nonprofit activity that is within the scope of ASC 810-10 (see Section 6 of our FRD, *Consolidated and other financial statements,* for guidance)
- A derecognition of a group of assets that is a business or nonprofit activity that is within the scope of ASC 810-10 (see Section 6 of our FRD, *Consolidated and other financial statements,* for guidance)

For transactions other than those listed above, the basic accounting question is whether the exchange transaction is recognized at fair value (resulting in gain or loss recognition if the fair value of the assets received differs from the carrying amount of the assets given up) or at historical cost (resulting in no gain recognition).

The following table, which is based on the one provided in ASC 810-10-55-2, summarizes the initial measurement for nonmonetary transactions that are covered in this section. Thereafter, the asset(s) received would be accounted for under applicable US GAAP.

<table>
<tr><th colspan="2" rowspan="2"></th><th colspan="4">Asset received</th></tr>
<tr><th>Controlled group of assets that meets the definition of a business</th><th>Controlled asset or group of assets that does not meet the definition of a business</th><th>Investment accounted for by the equity method</th><th>Investment accounted for by the cost method</th></tr>
<tr><td rowspan="4">Asset given up</td><td>Controlled group of assets that meets the definition of a business</td><td rowspan="4">Fair value
(ASC 805)
(Refer to N1.9.1)</td><td colspan="3">Apply the guidance in ASC 810
(Refer to N1.9.2)</td></tr>
<tr><td>Controlled asset or group of assets that does not meet the definition of a business</td><td>Fair value unless one of the exceptions to fair value is met
(Refer to N1.9.3)</td><td colspan="2">Either carryover basis or fair value
(If fair value, apply principles in ASC 845)
(Refer to N1.9.4)</td></tr>
<tr><td>Investment accounted for by the equity method</td><td rowspan="2">If the exchange is within the scope of ASC 860, apply that guidance. Otherwise, fair value unless one of the exceptions to fair value is met.
(Refer to N1.9.5)</td><td colspan="2" rowspan="2">If the exchange is within the scope of ASC 860, apply that guidance. Otherwise, either carryover basis or fair value.
(Refer to N1.9.5 and N1.9.6)</td></tr>
<tr><td>Investment accounted for by the cost method</td></tr>
</table>

See our FRD, *Transfers and Servicing of Financial Assets* for guidance on the scope of ASC 860 and the accounting for transactions within its scope.

N1.9.1 Exchanges in which the asset received is a controlled group of assets that meets the definition of a business

In transactions that involve entities swapping groups of assets, one main issue is whether the assets received constitute a business (see Section 2.1.3 in our FRD, *Business combinations,* for guidance in determining whether the assets received constitute a business). If the assets received constitute a business, then the transaction is accounted for as a business combination under ASC 805. In ASC 845-10-S99-3, the SEC Staff observed that the guidance in ASC 805 is followed regardless of whether the asset or groups of assets given up is a business, nonmonetary asset or equity method investment. This will result in the assets received being recognized at their fair value. In addition, the acquisition-date fair value of the assets given up is considered to be the consideration transferred in the business combination. This is illustrated in the following example.

Illustration N1-13: Exchange of assets for a business

Fact pattern

Entity A, a large diversified company, enters into an agreement with Entity B to exchange certain equipment owned by Entity A for 5 hotels of Entity B. Entity A also acquires the hotels' employees, the franchise agreements, inventory, reservations system and all "back office" operations from Entity B. Entity A's equipment has a carrying amount of $60 million and a fair value of $100 million.

Analysis

Because the acquired set has all three components of a business — inputs (long-lived assets, franchise agreement and employees), processes (operational and resource management processes associated with operating the hotels) and outputs (revenues from operating the hotels) — we generally believe that Entity A acquired a business. Therefore, Entity A accounts for the transaction as a business combination pursuant to ASC 805. The fair value of the consideration transferred is equal to the acquisition-date fair value of the equipment transferred, or $100 million, which results in Entity A recognizing a gain of $40 million ($100 million — $60 million).

N1.9.2 Exchange of a controlled group of assets that meets the definition of a business for a controlled asset or group of assets that does not meet the definition of a business or a noncontrolling ownership interest

As indicated in Section N1.9, ASC 845 does not apply to the derecognition of a group of assets (or deconsolidation of a subsidiary) that constitutes a business that is within the scope of ASC 810-10. Because the group of assets given up in this transaction constitutes a business, the transaction is accounted for pursuant to the guidance in ASC 810 unless one of the scope exceptions in ASC 810 applies (e.g., the transaction involves the sale of in-substance real estate). Entities should apply the guidance in ASC 810 regardless of whether the asset received is a controlled asset or group of assets that does not meet the definition of a business, an equity method investment or a cost method investment. See Section 6 in our FRD, *Consolidated and other financial statements,* for guidance on applying the requirements of ASC 810.

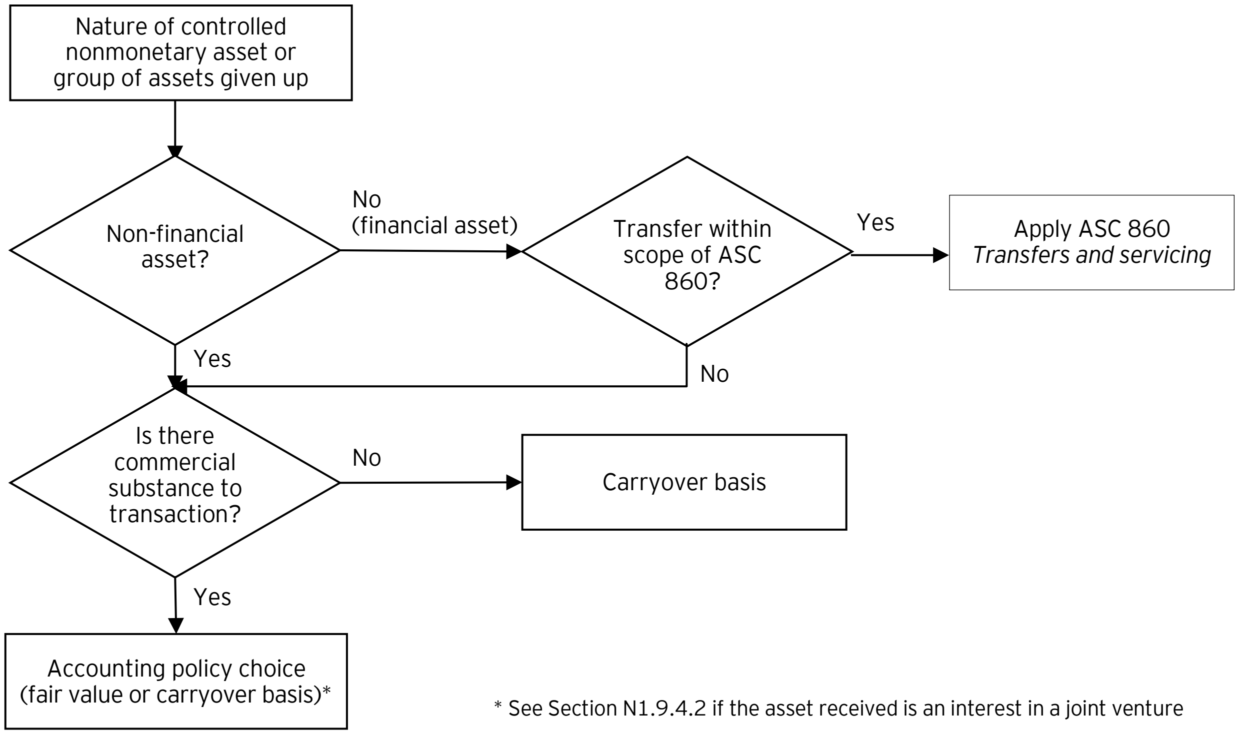
N1.9.3 Exchange of a controlled asset or group of assets that does not meet the definition of a business for another controlled asset or group of assets that does not meet the definition of a business

An exchange of a controlled asset or group of assets that does not meet the definition of a business for another controlled asset or group of assets that does not meet the definition of a business is accounted for in accordance with ASC 845 (i.e., recorded at fair value unless one of the three exceptions to fair value accounting discussed in Section N1.3 is met).

N1.9.4 Exchange of a controlled asset or group of assets that does not meet the definition of a business for a noncontrolling ownership interest

Based on informal discussions with the FASB staff, ASC 845 does not provide guidance when an entity exchanges a controlled asset or group of assets that does not meet the definition of a business for a noncontrolling ownership interest (e.g., an investment accounted for by either the equity method or the cost method) in that entity.[1] The following flowchart provides an overview of the appropriate accounting for such transactions:

[1] When the exchange involves solely a financial asset or a group of financial assets, we believe that entities should look to the guidance in ASC 860.



* See Section N1.9.4.2 if the asset received is an interest in a joint venture

The accounting for an exchange of a controlled asset or group of assets that does not meet the definition of a business for a noncontrolling ownership interest will depend on whether the exchange has commercial substance. If the exchange has commercial substance, we believe the exchange may be accounted for at either carrying amount (no gain recognition) or fair value (gain recognition). The policy followed for such transactions should be consistently applied to all similar transactions. If the exchange lacks commercial substance, we believe the exchange should be accounted for at carrying amount.

N1.9.4.1 Fair value accounting whether there is commercial substance

When an entity demonstrates commercial substance and elects to account for the exchange at fair value, the entity applies the guidance in ASC 845-10-30-24 through 30-27 to calculate the gain or loss. The guidance in these paragraphs addresses the accounting for an exchange of a nonfinancial asset for an equity method investment or a cost method investment. When an entity (Entity A) transfers a nonfinancial asset(s) to another entity (Entity B) in exchange for an equity method investment in that entity (Entity B), this will result in either full loss recognition or partial gain recognition.

If the fair value of the asset(s) given up (or of the ownership interest received if the fair value of that asset is more readily determinable) is less than its carrying value, that difference is recognized as a loss. On the other hand, if the fair value of the asset(s) given up (or of the ownership interest received if the fair value of that asset is more readily determinable) is greater than its carrying value, then a partial gain is recorded. The partial gain is calculated as the excess of the fair value of the asset(s) given up (or of the ownership interest received if the fair value of that asset is more readily determinable) over its carrying amount less the portion of that gain represented by the economic interest retained (which may be different from the voting interest).

If an entity (Entity A) transfers a nonfinancial asset to another entity (Entity B) in exchange for a cost method investment in that entity (Entity B), this will result in full gain recognition. That is, pursuant to ASC 845-10-30-26, the entity will recognize a gain for the excess of the fair value of the asset(s) given up (or of the ownership interest received if the fair value of that asset is more readily determinable) over its carrying amount.

These situations are illustrated in the following example.

Illustration N1-14: Exchange of a controlled asset or group of assets that does not meet the definition of a business for a noncontrolling ownership interest
Entity A transfers a nonfinancial asset with a carrying amount of $1,000 and a fair value of $2,000 to Entity B for a 30% economic interest in Entity B. Entity A recognizes a gain of $700 [($2,000 — $1,000) × 70%]. Thus, the amount recorded for Entity A's ownership interest in Entity B of $1,700 is partially based on its fair value at the exchange date ($1,400 = $2,000 * 70%) and partially based on the carrying amount of the asset given up ($300 = $1,000 * 30%). However, if Entity A receives a 10% ownership interest in Entity B and Entity A accounts for this ownership interest using the cost method instead of the equity method, Entity A would recognize a gain of $1,000 ($2,000 — $1,000) instead of $700. Thus, the amount recorded for Entity A's ownership interest in Entity B of $2,000 is based on its fair value at the exchange date.

In some situations, the entity may receive monetary consideration in addition to the noncontrolling ownership interest, thereby causing the entire exchange to be considered monetary. The accounting for such transactions is covered in Section N1.9.4.3.

N1.9.4.2 Exchanges between a joint venture and its owners

Because the guidance in ASC 845 does not apply to transfers of nonmonetary assets between a joint venture and its owners, if the noncontrolling ownership interest received is an interest in a joint venture, a question arises as to whether the transaction should be recorded at carrying amount or fair value. We believe that if the noncontrolling ownership interest received is in a joint venture, the exchange should generally be recorded at carrying amount (i.e., a gain should not be recognized) because the economic substance of the transaction is a contribution to the capital of an entity and not a sale. As a result, the scoping provisions of ASC 845 put significant pressure on whether the noncontrolling ownership interest received is an interest in a joint venture (instead of, for example, in an equity method investment). See Section 2 in our FRD, *Joint ventures,* for guidance on determining whether an entity meets the definition of a joint venture.

While ASC 845 excludes from its scope a transfer of nonmonetary assets between a corporate joint venture and its owners, ASC 845 includes nonmonetary transactions between the joint venturers themselves, unless another scope exception applies.

N1.9.4.3 Gain recognition in a monetary exchange of assets for a noncontrolling equity interest in an entity

ASC 845-10-25-9 addresses the accounting for a monetary exchange (required to be accounted for at fair value due to the magnitude of the boot) of a nonfinancial asset(s) for a noncontrolling ownership interest. In a monetary exchange in which an entity (Entity A) transfers a nonfinancial asset(s) to another entity (Entity B) in exchange for a noncontrolling ownership interest in the other entity (Entity B) and a significant cash payment, full or partial gain recognition is required. We believe the gain should be calculated in a manner consistent with the guidance in ASC 845-10-30-26 through 30-27 (see Section N1.9.4.1 for the application of this guidance). However, if Entity A has no actual or implied commitment[2], financial or otherwise, to support the operations of new Entity B in any manner, the amount of gain recognized, if applicable, may

[2] ASC 845-10-25-11 states that a transaction is committed to if the parties to the transaction have signed a binding, written agreement that specifically sets forth the principal provisions of the transaction. If any of the principal provisions are yet to be negotiated, or are subsequently changed, such a preliminary agreement does not qualify as a commitment for purposes of that guidance

exceed the amount that would be computed pursuant to the guidance in ASC 845-10-30-26 through 30-27. The following example from ASC 845-10-55-27 through 55-28 illustrates such a situation in which an entity transfers a nonmonetary asset to a newly created entity in exchange for a noncontrolling ownership interest and a significant cash payment made possible by the newly created entity being highly leveraged.

Illustration N1-15: Exchange of assets for an equity method investment and monetary consideration

Entity A transfers its ownership of an individual nonfinancial asset (or assets) to a newly created entity (Entity B) in exchange for an ownership interest in Entity B that will be accounted for by the equity method and monetary consideration. The monetary consideration received exceeds the fair value of the portion of the surrendered nonfinancial asset that has been sold in the exchange. The excess monetary consideration is funded by proceeds from nonrecourse financing within the newly created entity. Subsequent to the transfer, Entity A does not control Entity B. The specifics of the transaction are as follows:

a. Entity A owns equipment with a book basis of $100 and an appraised value of $400.

b. Entity B, previously unrelated to Entity A, creates a new subsidiary, Entity X, and transfers cash of $60 to Entity X.

c. Entity A transfers the equipment to Entity X in exchange for shares of Entity X stock that represent a 40% ownership interest in Entity X. Simultaneously, Entity X borrows $300 with recourse to only the equipment and pays Entity A $360 cash.

ASC 845-10-25-10 requires that if Entity A has no actual or implied commitment, financial or otherwise, to support the operations of Entity B in any manner, a gain of $260 is recognized because the investor's basis in the new entity should be no less than zero. The gain calculation is illustrated as follows:

Fair value of interest in equipment sold ($400 x 60%)	$ 240	
Less: Cost of interest in equipment sold ($100 x 60%)	(60)	
Plus: Additional gain to the extent of the negative investment	80	(a)
Total gain recognized	$ 260	
(a) Additional gain of $80 calculated as follows:		
Cost of equipment	$ 100	
Less: Cost of interest in the equipment sold	(60)	
Remaining cost	40	
Less: Cash received in excess of 60% of the equipment's fair value ($360 − $240)	(120)	
Negative investment	$ (80)	

Specific facts and circumstances may affect gain recognition and it would be impractical to consider all possible variations of the basic transaction described above.

In Illustration N1-15, Entity A recognizes a gain of $260 rather than a gain of $180 [($400 − $100) * 60%], which is the amount that would have been recognized pursuant to paragraph ASC 845-10-30-26.

N1.9.5 Exchange of a noncontrolling ownership interest for a controlled asset or group of assets that does not meet the definition of a business or for another noncontrolling ownership interest

ASC 845 excludes from its scope transfers of financial assets that fall within the scope of ASC 860. If an exchange of financial assets falls within the scope of ASC 860, the provisions specified therein should be followed.

ASC 845-10-55-2 specifies that the exchange of an equity method investment for another equity method investment (or for a controlled asset or group of assets that does not meet the definition of a business) is accounted for under the provisions of ASC 860 by the transferor of the equity method investment. However, before applying ASC 860, the scope provisions of ASC 860 should be carefully considered.[3]

In addition, we believe that similar exchanges should be carefully evaluated to determine whether they fall within the scope of ASC 860, including, for example, the following:

- The exchange of an equity method investment for cost method investment
- The exchange of a cost method investment accounted for an equity method investment, another cost method investment or for a controlled asset or group of assets that does not meet the definition of a business
- An exchange in which the asset given up was an interest in a joint venture and the asset received was either a controlled asset or group of assets that does not meet the definition of a business or an equity method investment (including another joint venture) or a cost method investment

If the exchange is not within the scope of ASC 860, we believe that entities should follow the guidance in ASC 845, and the accounting will depend on the nature of the asset received. If the asset received is a noncontrolling ownership interest, we believe that entities should follow the guidance described in Section N1.9.4. If the asset received is a controlled asset or group of assets that does not meet the definition of a business, we believe that entities should follow the general provisions of ASC 845. See Section 1.2 of our FRD, *Equity method investments,* for a framework to determine the nature of the equity interest received (e.g., equity method, cost method).

The flowchart in Section N1.9.4 illustrates the sequence of the guidance summarized above. The following table summarizes the accounting for the above exchanges under ASC 845 (that is, assuming the transaction is not within the scope of ASC 860):

		Asset received			
		Equity method investment	**Cost method investment**	**Controlled asset or group of assets that does not meet the definition of a business**	**Interest in a joint venture**
Asset given up	**Equity method investment , cost method investment or interest in a joint venture**	Either carryover basis or fair value if certain conditions are met (policy choice). If fair value, partial gain/full loss recognition.	Either carryover basis or fair value if certain conditions are met (policy choice). If fair value, full gain/full loss recognition.	Fair value, unless any of the exceptions to fair value is met (see Section N1.3).	We believe carryover basis.

[3] In determining whether the exchange is accounted for under ASC 860, entities should consider whether the exchange meets the definition of a "transfer" or is specifically exempted from its scope (e.g., the exchange involves investments by owners or distributions to owners of a business entity (ASC 860-10-15-4(f)).

Finally, specific literature addresses the accounting by a cost method investor for the nonmonetary exchange of cost method investments in which shares of one entity are being exchanged for all outstanding shares of the other as a result of a business combination. Section N1.9.6 provides guidance on how to account for such exchanges.

N1.9.6 Exchange of an investment accounted for by the cost method for another investment accounted for by the cost method in a business combination

ASC 325-20-30-2 through 30-6 address the accounting for nonmonetary exchanges of cost method investments in which shares of one entity are being exchanged for all outstanding shares of the other as a result of a business combination. This guidance also applies to nonmonetary exchanges of equity securities that fall within the scope of ASC 320 (e.g., available-for-sale equity securities). ASC 325-20-30-3 requires the investor to account for such exchanges at fair value, which means that the securities received are recorded at their fair value. For investments accounted for under the cost method, this treatment will result in the recognition of a gain or loss to the extent that the fair value differs from the investor's basis in the securities given up. For equity securities accounted for under ASC 320, any unrealized gains or losses recognized in other comprehensive income for the securities given up are recognized in earnings.

The following example illustrates a nonmonetary exchange of available-for-sale equity securities.

Illustration N1-16: Exchange of available-for-sale securities in a business combination

Entity X (the acquiring entity) enters into a business combination with Entity Y (the acquired entity). Shares of Entity X are exchanged for all of the outstanding shares of Entity Y. Prior to the exchange, Investors A, B, and C have the following equity investments in Entity X and Entity Y:

- Investor A owns shares of Entity X
- Investor B owns shares of Entity Y
- Investor C owns shares of Entity X and Entity Y

Pursuant to ASC 320, all three investors classify their investments as available-for-sale securities and have recorded their investments at fair value with the unrealized holding gains or losses recorded in other comprehensive income.

Based on the guidance in ASC 325-20-30, each investor should account for the exchange of Entity Y stock for Entity X stock as follows:

Investor A

Because Investor A did not participate in the exchange (that is, Investor A continues to hold shares in Entity X), Investor A continues to record any unrealized gain or loss on its investment in Entity X in other comprehensive income, not in earnings.

Investor B

Investor B should account for the exchange of its shares of Entity Y for shares of Entity X at fair value. A new cost basis is established for Investor B's investment and any gain or loss previously recorded in other comprehensive income for Investor B's investment in Entity Y is recognized in earnings. Any future holding gain or loss on Investor B's new investment in Entity X is recorded in other comprehensive income until realized.

Investor C

Investor C recognizes any gain or loss previously recorded in other comprehensive income for its investment in Entity Y in earnings at the time of the exchange. However, the unrealized gain or loss associated with the shares of Entity X that were owned by Investor C prior to the exchange continues to be recorded in other comprehensive income.

There have been questions regarding securities received that are restricted but whose restrictions lapse in less than one year and, therefore, are accounted for under ASC 320. ASC 320-10-30-1 states that the fair value of a restricted stock is measured initially based on the quoted market price of an otherwise identical unrestricted security of the same issuer, adjusted for the effect of the restriction, in accordance with ASC 820 (thus reducing the amount of the gain or increasing the amount of the loss that would have been recognized had the securities not been restricted). ASC 820 clarifies that a fair value measurement for a restricted asset considers the effect of the restriction if market participants would consider the effect of the restriction in pricing the asset. For example, if a restriction is deemed to be an attribute of the asset that would conceptually transfer with the asset in a hypothetical sale, it would likely be considered by market participants in pricing the asset. Alternatively, a restriction that is deemed to be specific to the reporting entity currently holding the asset that would not transfer in a hypothetical sale would not be considered by market participants. Refer to our FRD, *Fair value measurement,* for additional discussion on the consideration of restrictions when estimating fair value.

N1.10 Exchange of the capital stock of an entity for nonmonetary assets or services

Entities often sell goods or provide services in exchange for equity instruments issued by the purchaser of the goods or services. ASC 845 excludes from its scope acquisitions of nonmonetary assets or services on issuance of the capital stock of an entity.

The entity granting the equity instruments follows the appropriate accounting guidance for those transactions in ASC 718-10 and ASC 505-50. Such transactions are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Because the equity instruments issued may vest as performance occurs or if certain conditions are met, questions may arise regarding the appropriate date to use to measure the fair value of the equity instruments issued. ASC 505-50 addresses the measurement date from the standpoint of the grantor in these types of transactions. Refer to Section 9 in our FRD, Share-based payment, for additional guidance.

The entity receiving equity instruments in exchange for providing goods or services accounts for the transaction in accordance with ASC 845, that is, at fair value, unless one of the exceptions (described in Section N1.3) is met. ASC 505-50-30-18 addresses the measurement date for the receiving entity in these types of transactions.

N1.10.1 Transfers of nonmonetary assets that do not meet the definition of a business by promoters or shareholders

SAB 48 (Topic 5.G, codified in ASC 845-10-S99-1) addresses the accounting for an exchange of nonmonetary assets by promoters[4] or shareholders for all or part of an entity's common stock just prior to or contemporaneously with a first–time public offering.

Topic 5.G states that transfers of nonmonetary assets that do not meet the definition of a business to an entity by its promoters or shareholders in exchange for stock just prior to or at the time of the entity's initial public offering generally is recorded at the transferors' historical cost basis. Topic 5.G indicates that in rare circumstances it may be appropriate to use fair value rather than predecessor cost to value nonmonetary assets received from an entity's promoters or shareholders. In such situations, the fair value of either the stock or assets acquired must be objectively measurable and the transferor's stock ownership following the transaction should not be so significant that the transferor has retained a substantial indirect interest in the assets as a result of stock ownership in the entity.

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[4] Promoters are defined in Rule S-X 1-02(s) as persons founding or organizing the entity; persons who receive 10% or more of the stock of the entity in connection with its founding or organization.

The SEC Staff also addressed situations in which the registrant acquires treasury stock from promoters or stockholders in exchange for nonmonetary assets prior to the initial public offering. The position of the SEC Staff is that unless clear evidence exists that substantiates the fair value of the stock reacquired and the fair value of the assets transferred to the promoters/stockholders, the registrant should not recognize a gain on such an exchange. Rather, the registrant should record the treasury stock at the net book value of the assets exchanged.[5]

N1.10.2 Transactions with principal shareholders for an entity's benefit

If a principal owner[6] of an entity enters into a transaction with a third party that has a business relationship with the entity, the facts and circumstances may indicate that the purpose of the transaction is to benefit the entity, even if the entity is not directly involved. This type of transaction would be a related party transaction. See Section R1.3 of the Accounting Manual for further discussion of the disclosure requirements for such transactions.

ASC 225-10-S99-4 *Income Statement — Overall — SEC Materials* states that when an entity's principal shareholder transfers a portion of his shares to a plaintiff to settle litigation against the entity, the settlement should be recognized as an expense in the entity's financial statements with a corresponding credit being a capital transaction (i.e., paid-in capital). ASC 225-10-S99-4 states that the SEC staff believes this transaction is similar to one in ASC 718, in which a principal shareholder establishes or finances a stock plan for employees of an entity. ASC 718 describes the problem of separating the benefit to the principal shareholder from the benefit to the entity. Therefore, ASC 718 requires the entity to recognize compensation expense and a capital contribution. See Section 2.3 of our FRD, *Share-based payment*, for guidance on the accounting required by ASC 718.

ASC 225-10-S99-4 also states that the SEC staff believes that similar accounting is required in other transactions in which a principal shareholder pays an expense for a registrant, unless the shareholder's action is caused by a relationship or obligation unrelated to his or her position as shareholder or clearly does not benefit the registrant. These views are consistent with ASC 470-50-40-2 *Debt — Modifications and Extinguishments — Other Presentation Matters*, which states that the extinguishment of a debt between related parties may be in essence a capital transaction.

N1.11 Nonmonetary transactions involving advertising barter

See Section R3.11.3 of the Accounting Manual.

N1.12 Barter credits

An entity may enter into a transaction to exchange a nonmonetary asset (e.g., inventory) for barter credits. The transaction might be done directly with another entity that will provide goods or services, or it might be done through a barter broker or network. The barter credits can be used to purchase goods or services (e.g., advertising time, airline tickets, hotel rooms, phone service) from either the barter entity or members of its barter exchange network. The goods and services to be purchased may be specified in a barter contract or limited to items made available by members of the exchange network. Some arrangements may require the payment of cash in addition to the barter credits to purchase goods or services. Barter credits also may have a contractual expiration date, at which time they become worthless.

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[5] Nineteenth Annual National Conference on Current SEC Developments — 1992, SEC Staff Interpretations in Registrant Matters Involving Accounting and Auditing Issues ("Nonmonetary Transactions Involving Transfers to Promoters/Stockholders or Spin-offs")

[6] A principal owner is defined in ASC 850 as an owner of record or known beneficial owner that holds more than 10 percent of the voting stock of an entity.

In typical corporate barter transactions, an entity gives up nonmonetary assets (e.g., inventory, buildings or real estate) in exchange for barter credits from a barter entity. The barter credits obligate the barter entity to use its best efforts to provide goods or services in the future. The terms and conditions of a corporate barter arrangement depend on the particular facts and circumstances. Prior to entering into the barter arrangement, the barter entity may arrange for a third party to purchase the nonmonetary assets the barter entity will be receiving. The negotiated price between the barter entity and the third party for the nonmonetary assets is almost always less than the recorded carrying value of the nonmonetary assets. Typically, the price approximates a liquidation or wholesale value. The barter entity generally issues barter credits to the entity in an amount equal to or more than the recorded carrying value of the nonmonetary assets on the entity's books. In the future, the entity can apply the barter credits, often along with a cash payment, to purchase future goods or services through the barter entity. When satisfying its "best efforts" obligation to the entity, the barter entity may require that the cash component from the entity cover the barter entity's actual or expected cost of the goods (or services), such as advertising, plus in some cases a reasonable gross profit margin.

Transactions in which nonmonetary assets are exchanged for barter credits are accounted for under ASC 845. ASC 845 is applicable to barter transactions entered into directly with the service provider or entered into with a barter entity or members of its barter exchange network. As discussed in Section N1.3, the basic principle of ASC 845 is that accounting for nonmonetary transactions is based on the fair values of the assets or services involved. In barter transactions, ASC 845-10-30-17 states that it is presumed that the fair value of the nonmonetary asset exchanged (i.e., given up) is more clearly evident than the fair value of the barter credits received and that the barter credits are recorded at the fair value of the nonmonetary asset exchanged. However, ASC 845-10-30-18 explains that this presumption may be overcome if (a) the entity can convert the barter credits into cash in the near term, as evidenced by a historical practice of converting barter credits into cash shortly after receipt or (b) independent quoted market prices exist for items to be received upon exchange of the barter credits. Such situations are expected to be rare.

The determination of the fair value of the asset given up (e.g., inventory) in a barter transaction requires the use of judgment and a careful analysis of the facts and circumstances. In barter transactions, it is presumed that the fair value of the nonmonetary asset given up is less than the carrying amount of the asset and, therefore, an impairment loss would be recognized prior to recording the exchange. The basis for this presumption is that most entities most likely would sell inventory for cash rather than barter credits. Therefore, the mere fact that an entity is bartering with inventory would indicate the entity's normal selling price is not an appropriate measure of fair value. Thus, it is unlikely this presumption can be overcome. In addition, this raises lower-of-cost-or-market valuation questions about any similar items remaining in inventory.

In some cases, barter arrangements require cash payments in addition to the barter credits for the entity to purchase the goods or services. For example, an entity may exchange inventory for barter credits for advertising time. However, the entity must also pay cash to obtain the advertising time (e.g., 50% of list price). In this situation, it is generally presumed that the inventory is worthless and that the entity is simply paying cash for the advertising. Therefore, an impairment loss would be recognized related to the inventory prior to recording the barter exchange transaction. Even if no cash is required when the barter credits are used, the fact the excess inventory is disposed of through a barter transaction strongly suggests the value of the inventory may be minimal or even zero. Thus, a determination that the inventory exchanged does have value (although below cost) should be supported by persuasive evidence such as actual sales of sufficient quantities of other items of the same type inventory. After the inventory is written down to a supportable fair value amount, the exchange is recognized by recording the barter credits as an asset equal to the new carrying amount of the inventory given up and such barter asset is amortized to expense as the credits are used (e.g., for advertising).

Assuming the inventory exchanged still has value and has not been written down to zero, an impairment loss on the barter credits is recognized if it subsequently becomes apparent that (1) the fair value of any remaining barter credits is less than their carrying amount or (2) it is probable the entity will not use all the remaining barter credits. As part of evaluating the recorded amount of barter credits, which typically would be carried as a prepaid asset, an assessment of the likelihood the counterparty will perform is necessary. If the barter credits are issued directly by another entity that will provide the goods or services, the credit worthiness of the counterparty should be evaluated (e.g., consider the credit rating of the counterparty). If the credits are issued by a barter broker or network, the credibility and history of the broker or network should be evaluated. When assessing whether the entity will use all the remaining barter credits, considerations include whether: (1) the entity can use the barter credits based on current and future operations, (2) the barter credits have an expiration date or (3) the entity will benefit from use of the barter credits for goods and services.

If an exchange involves the transfer or assumption of an operating lease for barter credits, impairment of that lease is measured as the excess of remaining lease costs (discounted rental payments and unamortized leasehold improvements) over the discounted amount of probable sublease rentals for the remaining lease term.

It is important that in auditing these nonmonetary exchanges, we have a full understanding of the entire transaction and maintain an appropriate degree of skepticism.

The following examples from SEC Accounting and Auditing Enforcement Releases illustrate barter transactions that were determined by the SEC Staff to have been inappropriately accounted for by the registrant and improperly evaluated by the registrant's auditors.

Illustration N1-17: Exchange of obsolete inventory for barter credits

In April 20X1, the Company entered into an agreement with a media buying agency ("barter company"). As part of the agreement, the Company exchanged obsolete inventory for advertising credits. The Company avoided writing down the value of the obsolete inventory, which was recorded on the Company's books at $2,500,000, by converting it into prepaid advertising which was recorded at the same amount. As part of the agreement with the barter company the prepaid advertising had to be used before April 20X3. Only a portion of the credit was used during 20X1.

In this case, according to the SEC, the auditors did not adequately consider that this transaction differed from a standard prepaid transaction in that it involved an exchange of nonmonetary items. To audit the value of the transaction on the Company's books, the auditors contacted the barter company to determine the amount of the credit remaining at year-end and obtained the Company's financial budget and management representation that it intended to use the credit. The SEC staff did not consider these procedures adequate.

In addition, the SEC staff did not believe the auditors adequately considered that barter companies typically engage in such transactions to "sell advertising credits" for cash and the reason that the transaction was structured as an exchange of inventory was so the buyer (i.e., the Company) could get obsolete inventory off its books without writing the inventory down. As part of this barter arrangement, the Company was required to pay the barter company between one and five dollars for each dollar of advertising credit used, depending on the type of advertising services. This cash payment was, at least, equal to the cost of the advertising services to the barter company. The inventory received by the barter company was almost incidental to the transaction. Generally, barter companies do not assign substantial value to inventory exchanged in this manner. For example, the barter company valued the inventory received as part of the transaction at only $50,000 and subsequently sold the inventory for only $10,500.

In summary, the SEC staff believed the auditors did not obtain sufficient competent audit evidence supporting the propriety of the account balance. The auditors were aware the bartered inventory had been designated as slow moving at the end of the prior year and no reserve had been established. The auditors also were aware the Company had used only a portion of the advertising credits during the peak advertising season in 20X1. The Company did not appear able to fully utilize the credit before its April 20X3 expiration date. Therefore, the SEC staff concluded the auditors had sufficient information to determine that the account should have been written down in accordance with generally accepted accounting principles.

Illustration N1-18: Improper recognition of revenue in exchange for barter credits

In two barter-type exchanges in 20X7, Company A shipped computer software products it valued at approximately $250,000 in exchange for advertising services to be received in the future. As part of the agreements with two advertising companies, Company A was obligated to make cash payments, in addition to the computer software already shipped, in order to receive the advertising. The SEC staff asserted that Company A recorded revenue from these transactions although it was evident at the time its 31 December 20X7 financial statements were prepared that the Company would receive little or no advertising. Company A eventually received less than $10,000 worth of services under the agreements. The SEC staff asserted that the improperly recognized revenue from these transactions amounted to 7% of Company A's revenue for the period and Company A improperly understated its net loss for the period by approximately 12%.

N1.13 Disclosure requirements

An entity that engages in one or more nonmonetary transactions during a period is required to disclose the following:

- The nature of the transactions
- The basis of accounting for the assets transferred
- Gains or losses recognized on transfers
- Gross operating revenue recognized as a result of nonmonetary transactions (see ASC 505-50 for guidance)
- Revenue and costs (or gains and losses) associated with inventory exchanges recognized at fair value

N1.14 SEC staff observations

When a registrant has recognized a nonmonetary transaction or a nonreciprocal transfer at fair value, the SEC staff may challenge certain aspects of the accounting including:

- How the exchange has commercial substance when the goods or services being exchanged appear similar
- How the fair value of the asset received is more clearly evident than the fair value of the asset given up
- How the fair value of the asset given up was measured in accordance with ASC 820 (and whether all of the required disclosures under ASC 820 have been made)
- Why the fair value of the asset given up approximated its book value (when applicable)

- How the boot was evaluated relative to the fair value of the exchange (i.e., its significance)
- In a nonreciprocal transfer of nonmonetary assets, how the fair value is (1) objectively measurable and (2) clearly realizable to the transferor in an outright sale at or near the time of the distribution

See our FRD, *Fair value measurement,* for guidance on determining fair value, including required disclosures.

When a nonmonetary transaction is with a customer (for example, a trade-in of goods), we also have observed the SEC Staff question whether the registrant has appropriately applied ASC 605 to determine whether (or when) the criteria for revenue recognition were met, and whether such transactions were appropriately categorized as revenues (vs. other income).