17. Accounting for Asset Exchanges

You may have bought a new car and part of what you gave to obtain the new car was a "trade in" of a different car. This would be a classic "exchange" transaction. In business, equipment is often exchanged (e.g., an old copy machine for a new one). Sometimes land is exchanged. Exchanges are often motivated by tax rules because neither company may be required to recognize a taxable event on the exchange; quite different than the tax outcome of an outright sale. Whatever the motivation behind the transaction, the accountant is again pressed to measure and report the event.

17.1 Commercial Substance

The accounting rules for exchanges once hinged on whether swapped assets were similar or dissimilar. However, in a move to establish international accounting harmony, the FASB has adopted a global view that all exchanges that have "commercial substance" (future cash flows of the entity are expected to change because of the exchange) should be accounted for at fair value.

17.2 Recording the Initial Investments

This approach will ordinarily result in recognition of a gain or loss because the fair value will typically differ from the recorded book value for the swapped assets. There is deemed to be a culmination of the earnings process when assets are swapped -- one productive component is liquidated and another is put in its place. There are many possible scenarios:

Example A: Loss Implied

Company A gives an old truck ($1,000,000 cost, $750,000 accumulated deprecation) for a boat. The fair value of the old truck is $150,000 (which is also deemed to be the fair value of the boat). The boat should be recorded at fair value; since that amount is less than the net book value of the old truck, a loss is recorded (for the difference):

6-30-X3	Accumulated Depreciation (old)		750,000	
	Loss		100,000	
	Equipment (new)		150,000	
	Equipment (old)			1,000,000
	To remove all accounts related to the old truck, set up the new boat at its fair value, and record the balancing loss.			

Example B: Gain Implied
Company A gives an old truck ($1,000,000 cost, $750,000 accumulated deprecation) for a boat. The fair value of the old truck is $350,000 (which is also deemed to be the fair value of the boat). The boat should be recorded at fair value; since that amount is more than the net book value of the old truck, a gain is recorded (for the difference):

6-30-X3	Accumulated Depreciation (old)		750,000	
	Equipment (new)		350,000	
	Gain			100,000
	Equipment (old)			1,000,000
	To remove all accounts related to the old truck, set up the new boat at its fair value, and record the balancing gain.			

17.3 Boot

Exchange transactions are oftentimes accompanied by giving or receiving "boot." Boot is the term used to describe additional monetary consideration that may accompany an exchange transaction. Its presence only slightly modifies the above accounting by adding one more account (typically Cash) to the journal entry. For instance, assume Example A is amended to add the following facts: Company A also gave $50,000 cash along with the old truck, because the old truck was only worth $100,000:

6-30-X3	Accumulated Depreciation (old)		750,000	
	Loss		150,000	
	Equipment (new)		150,000	
	Cash			50,000
	Equipment (old)			1,000,000
	To remove all accounts related to the old truck and cash, set up the new boat at its fair value, and record the balancing loss.			

Notice that this entry has an added credit to Cash reflecting the additional consideration. The offsetting loss has increased to $150,000. The loss is the balancing amount, and reflects that $300,000 of consideration (cash ($50,000) and an old item of equipment ($1,000,000 - $750,000 = $250,000)) was swapped for an item worth only $150,000. Had boot been received, the cash would have instead been debited (and a smaller loss, or possibly a gain, would be recorded to balance the entry).

17.4 Exchanges Lacking Commercial Substance

Some exchanges may not have commercial substance. For example, a car dealer may have an oversupply of red cars and not enough green ones. To rebalance inventory, they swap red for green with another dealer; no significant change in cash flows is expected because of this trade. In this case, the exchange lacks "commercial substance," and no gain is to be recorded. The green cars are simply recorded at the cost of the red cars (a loss might be recorded if impairment is suggested). If an exchange lacking commercial substance also entails the receipt of boot, a proportionate amount of gain in relation