EXHIBIT 1

Trade-in of Equipment (Plus Boot):
Commercial Substance—Change in Configuration of Future Cash Flows

Spirit Wineries, Inc., owns several crusher-destemmer machines used to peel, press, and extract juice from grapes during harvest. One of the large-capacity units, though operating well, is oversized for the current facility and less efficient than desired. This unit originally cost $100,000 and has accumulated depreciation of $40,000. Its fair value is $70,000, an amount quoted by an independent dealer. Spirit purchases a new model, costing $90,000, by trading in its existing unit and paying cash of $20,000.

Analysis

Prior GAAP. Under APBO 29, this transaction would represent an exchange of similar productive assets. Accordingly, the gain of $10,000 (fair value of $70,000 less net book value of $60,000) would be deferred, and the new crusher would be recorded at $80,000 (net book value of $60,000 plus boot paid of $20,000). The following journal entry illustrates this exchange:

Dr. Equipment, New	$80,000	
Dr. Accumulated Depreciation, Old	40,000	
Cr. Equipment, Old		$100,000
Cr. Cash		20,000

SFAS 153. Under SFAS 153, Spirit must assess whether the exchange has commercial substance. Accordingly, Spirit examines whether there will be a significant change in the configuration of future cash flows. Though SFAS 153 does not require a detailed quantitative analysis, management examines the risk, timing, and amount of cash flows as part of its capital budgeting process. The analysis reveals that the change in the amount and timing from the upfront cash payment, coupled with projected higher throughput and lower processing costs from the new unit, will likely have a significant economic impact. Spirit concludes that the transaction has commercial substance.

Spirit will record the new equipment at its fair value of $90,000 and recognize the gain of $10,000 on the trade-in of the old equipment. The journal entry is as follows:

Dr. Equipment, New	$90,000	
Dr. Accumulated Depreciation, Old	40,000	
Cr. Equipment, Old		$100,000
Cr. Cash		20,000
Cr. Gain on Exchange		10,000

Compared with APBO 29, the commercial substance approach under SFAS 153 results in a higher asset valuation and a recognized gain of $10,000. For tax purposes, Spirit would not recognize any gain on this transaction. Spirit will, however, have a deferred tax liability under SFAS 109.