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Ms. Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5166
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1 October 2012

Re: Proposed Accounting Standards Update, *The Liquidation Basis of Accounting* (File Reference No. 2012-210)

Dear Ms. Cospers:

We appreciate the opportunity to comment on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update, *The Liquidation Basis of Accounting* (the Proposed Update).

We support the Board's efforts to provide guidance on how and when to apply the liquidation basis of accounting. This Proposed Update would promote consistency in how and when entities apply the liquidation basis of accounting and would provide information that is more relevant to users of the financial statements. In addition, in its going concern project, we urge the Board to require management to take responsibility for evaluating the entity's ability to continue as a going concern, and to clarify the required disclosures regarding this evaluation.

We agree with the Board's proposal to require the use of the liquidation basis of accounting only when liquidation is imminent, as defined, and to set an appropriately high threshold for using the liquidation basis. We also agree with the Board's proposal that when liquidation is imminent, the guidance should apply to all entities (both public and private), including investment companies and defined contribution plans, and we agree with the Board's proposal that limited-life entities should not prepare financial statements on the liquidation basis of accounting, but instead should continue using the going concern basis.

However, we understand the going concern basis and the liquidation basis to be two fundamentally different bases of accounting. Therefore, we are concerned that Proposed Update 205-30-05-3 states, "The accounting and reporting guidance [regarding liquidation basis financial statements] is **incremental** to guidance that otherwise applies to an entity" (emphasis added). The measurement requirements of the Proposed Update conflict with the measurement requirements in almost all other sections of the codification, and the recognition requirements also conflict in some cases (such as in the recognition of costs that have not been incurred). Many of the disclosures required by other sections of the codification also would be irrelevant to users of liquidation basis financial statements, once the accounting basis changes. While we acknowledge that an entity might sometimes look to the guidance for entities that are going concerns, the liquidation basis of accounting should be a separate

part of the codification. An entity either would use the going concern basis of accounting (that is, all other parts of the codification) or would use the liquidation basis of accounting.

Consistent with our belief that the liquidation basis is fundamentally different from the going concern basis, entities that apply the liquidation basis should be exempt from applying new US GAAP guidance that becomes effective after liquidation becomes imminent and the basis of accounting changes from the going concern basis to the liquidation basis. Our views on this point are discussed in more detail in our response to Question 2.

Our responses to the Board's specific questions for respondents, along with other comments about clarifications that would help make the proposal operational and promote consistent application, are included in the Appendix.

* * * * *

We would be pleased to discuss our comments with the Board or the FASB staff at your convenience.

Very truly yours,

A handwritten signature in black ink that reads 'Ernst & Young LLP' in a cursive, script font.

Responses to the Questions for Respondents in the Proposed Accounting Standards Update, *The Liquidation Basis of Accounting*

Question 1: The proposed guidance would require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent, as defined in the proposed guidance. Is the proposed guidance about when an entity should apply the liquidation basis of accounting appropriate and operational? If not, why?

Yes, we generally agree that the proposed guidance about when an entity should apply the liquidation basis of accounting is appropriate. This proposed guidance will promote consistency in when and how entities apply the liquidation basis of accounting, and provide financial information that is more relevant to users.

By requiring the use of the liquidation basis of accounting only when liquidation is imminent, which means that there is only a remote possibility that liquidation would not occur, the proposal provides an appropriately high threshold for when to apply the liquidation basis of accounting and would help ensure that most entities use the going concern basis of accounting.

We also agree with the Board's 2 May 2012 decision "to revisit the question of whether management should be required to assess whether there is doubt about an entity's ability to continue as a going concern in light of its recent decision not to pursue going-concern-type disclosures in the project about liquidity and interest rate risk disclosures." We urge the Board to require management to take responsibility for evaluating the entity's ability to continue as a going concern, and to clarify the required disclosures in such situations.

Currently, an entity is a going concern when it has the ability to realize its assets and discharge its liabilities in the normal course of operations for one year from the balance sheet date. In contrast, an entity would use the liquidation basis of accounting only when liquidation is imminent. There may be a gap in this continuum. The Proposed Update does not explicitly address a situation in which there might be substantial doubt about an entity's ability to continue as a going concern, but in which liquidation is not yet imminent. If the Board intended for an entity to use the going concern basis of accounting during such a period, until liquidation is imminent, this point should be clarified in the final standard.

Other clarifications also are needed to help ensure the proposal is operational, as described below.

Evaluating the role of parties involved

The description of when liquidation is imminent in Proposed ASU 205-30-25-2 refers to the "person or persons with the authority to make such a plan effective." Example 1 in the proposed implementation guidance refers to a situation in which the board of directors makes decisions and no parties can block the execution of its plan. While Example 1 is helpful, the Board should consider addressing other situations frequently seen in practice and include examples to illustrate when liquidation becomes imminent in those situations.

For example, liquidation generally would require shareholder approval. When liquidation occurs after a voluntary bankruptcy filing, it typically requires the approval of a trustee or court confirmation.

Similarly, most employee benefit plans require IRS approval before termination (and the IRS sometimes rejects the termination of an employee benefit plan). When such third parties are involved, it is not clear whether their approval would be required to conclude that liquidation is imminent.

Emphasis on decisions versus actions

Proposed Update 205-30-25-1 states: "Liquidation is imminent when either of the following occurs:

- ▶ A plan for liquidation has been approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties (for example, with protective rights).
- ▶ A plan for liquidation is imposed by other forces ... and the likelihood is remote that the entity will return from liquidation."

There needs to be a clear principle underlying the determination of when liquidation accounting begins. We observed inconsistencies in the Proposed Update as to whether liquidation accounting begins when (1) decisions are made or (2) actions occur. This distinction is particularly important when a decision to liquidate occurs before the end of a reporting period, but the actions of liquidating begin after the end of the reporting period. The distinction is also important when power is delegated to an agent that may be responsible for acting on the decisions made by those in authority. Two examples in which we perceived inconsistencies are described below.

One example of this inconsistency is in Example 2 in Proposed Update 205-30-55-3. Currently, Example 2 implies that liquidation became imminent when Entity B actually began disposing its properties. Example 2, as drafted, contradicts two aspects of "imminent," as described in Proposed Update 205-30-25-2. First, it ignores the consideration of when a party with authority approved the liquidation plan, which is required in Proposed Update 205-30-25-2(a). It implies that liquidation is imminent when the entity begins to execute the plan, rather than when the plan is approved. Second, it also implies that the cessation of "significant management **activities**" drives the determination of when liquidation is imminent, but Proposed Update 205-30-25-3 refers specifically to "significant management **decisions**." While we support including an example of when liquidation accounting begins for a limited-life entity that has an unplanned liquidation, Example 2 should be consistent with the underlying principle.

A second example of this inconsistency is in the accounting for employee benefit plans in which many of the current recognition requirements were retained. The Board is proposing to retain, with modification, the requirement that "If the decision to terminate the plan is made before the end of the plan year, the plan's year-end financial statements shall be prepared using the liquidation basis of accounting." We are concerned that there may be differences between "when a decision is made" and when "liquidation is imminent," as defined in the Proposed Update and referenced above. For example, the trustees of an employee benefit plan may decide to terminate the plan, but the termination requires IRS approval and there is more than a remote possibility that the IRS will block the termination. To avoid this conflict, the Board should consider revising ASC 960-40-25-1, ASC 962-40-25-1 and ASC 965-40-25-1, to refer to the final standard to determine when and how to apply the liquidation basis of accounting for an employee benefit plan.

When a benefit plan sponsor defaults, the Pension Benefit Guaranty Corporation (PBGC) may take over payments to participants. In this circumstance, it is not clear whether the liquidation basis of accounting would be appropriate, and if so, whether liquidation becomes imminent when the PBGC decides to take over, or actually takes over, when there is a lag between the two dates.

Liquidation as a result of an acquisition or merger

The definition of liquidation in the Proposed Update states: "Dissolutions via acquisition or merger do not qualify as liquidations." This wording is not clear and may have unintended consequences. An entity that is liquidating frequently sells its assets, resulting in an acquisition by a third party. Read broadly, the definition of liquidation would scope out all acquisitions. If the Board intended to scope out certain transactions, that should be reflected in the scope of the Proposed Update.

Inclusion of a convenience date

As described in the Proposed Update, the liquidation of an entity frequently would become imminent on a date other than the end of its reporting period. In practice, we understand that when entities prepare financial statements on the liquidation basis of accounting, they frequently use a convenience date, such as the beginning of the reporting period, because it is often difficult to determine the exact date that liquidation became imminent. The final standard should specifically allow entities to use a convenience date if the difference between the convenience date and the date liquidation becomes imminent is not significant. The cost savings that an entity may obtain from using a convenience date would outweigh any potential differences created since its ending net assets in liquidation would be the same.

Other drafting comments

We understand that when an entity is liquidating, the process frequently takes more than a year to complete. It is our understanding that the Proposed Update would not preclude such an entity from concluding that liquidation was imminent, as long as one of the criteria in Proposed Update 205-30-25-2 is met. The Proposed Update should be clarified to state that an entity **begins** applying the liquidation basis of accounting when liquidation is imminent - that is, when the criteria in 205-30-25-2 are met - and continues to apply the liquidation basis until liquidation is complete, which may be for an extended period.

We are concerned that certain language in the Proposed Update may unintentionally exclude some entities from the scope of the guidance. Proposed Update ASC 205-30-05-2 states that it "addresses the accounting and financial statement disclosure for entities that may have filed petitions with the bankruptcy court and expect to liquidate under Chapter 7 of the bankruptcy code." The proposed liquidation guidance should apply to all entities that are liquidating, including contractual, voluntary or foreign involuntary liquidations. We recommend clarifying that Chapter 7 liquidations are not the only liquidations to which the final standard would apply.

Question 2: The proposed guidance includes a principle for measuring assets and liabilities, as well as related items of income and expense, using the liquidation basis of accounting. The proposed guidance would require supplemental disclosures about the methods and assumptions used in arriving at those measurements. This guidance is intentionally nonprescriptive in light of the specialized nature of liquidation basis financial statements and the impracticability of providing prescriptive guidance for the myriad of circumstances to which it might apply. Is the proposed guidance on how to prepare financial statements using the liquidation basis sufficient and operational? If not, why?

We generally agree with the Board's proposals. However, as discussed in our cover letter, we are concerned that Proposed Update 205-30-05-3 states: "The accounting and reporting guidance [regarding liquidation basis financial statements] is **incremental** to guidance that otherwise applies to an entity" (emphasis added).

Because the going concern basis and liquidation basis are fundamentally different, entities should not be required to prepare certain disclosures that would otherwise be required under the going concern basis. Proposed Update 205-30-50-1 requires new disclosures "in addition to all other disclosures required by US GAAP." It is not clear why disclosures that would be required under other US GAAP, particularly those relating to assets and previous transactions, would be relevant to the users of liquidation basis financial statements since they provide little or no information about the cash available to investors upon liquidation.

For example, the following disclosures would appear to provide little benefit to users of liquidation basis financial statements: business combinations and asset acquisitions; inventory; property, plant and equipment; rollforwards of goodwill and other intangible assets; share-based payment plans; restructuring activities; discontinued operations; fair value disclosures; and segment disclosures. If the Board did not intend to require these disclosures, that fact should be stated explicitly.

We acknowledge that users would benefit from the disclosure of disaggregated information about expected cash inflows and outflows and the periods over which the realization of assets, and the settlement of liabilities, is expected to occur. However, the Board should specifically identify in the final standard the disclosures that need to be provided in liquidation basis financial statements. The decisions about which disclosures are required should be based on meeting the objective of liquidation basis financial statements, which is to provide information about the cash available to investors after liquidation.

In addition, consistent with our belief that the liquidation basis is fundamentally different from the going concern basis, entities that apply the liquidation basis of accounting should be exempt from applying new US GAAP guidance that becomes effective after liquidation becomes imminent and the basis of accounting changes from the going concern basis to the liquidation basis.

For example, assume a new leasing standard became effective after liquidation accounting begins. If the guidance in the Proposed Update were considered incremental to other US GAAP, absent a specific exemption, the entity would be required to adopt the new leasing standard. It would be required to recognize liabilities for all its lease obligations in the liquidation basis financial statements, as well as in any prior period and stub period financial statements prepared on a going concern basis.

The entity would likely incur significant costs to adopt the new standard, with little benefit, because it would likely already disclose amounts it expects to pay for its leasing obligations in its liquidation basis financial statements.

We understand that the Board may not have intended for entities to adopt new accounting standards when applying the liquidation basis of accounting. However, this issue should be explicitly addressed in the final standard. If adoption of new standards is required, it would be helpful to understand the Board's considerations in reaching this conclusion.

While we agree with the Board's decision not to be overly prescriptive, clarification is needed in some instances to make the standard operational and help ensure that it is applied consistently. Our concerns are as follows.

Measurement

The measurement basis of "expects to collect or pay" is not clear in Proposed Update 205-30-30-1, and diversity likely will result without clarification. For example, when the amount that an entity expects to collect or pay falls within a range of possible amounts, it is unclear what amount should be recognized. Using a measurement basis similar to that used in ASC 450 for loss contingencies would appear to be most appropriate. Using other estimates, for example, a probability-weighted amount would outweigh the benefits from using such an estimate.

The Board also should explicitly address whether discounting cash flows for the time value of money is required when measuring the amount expected to be collected or paid. Proposed Update 205-30-50-1(c) states that disclosures of "significant methods and assumptions might include... discount rates used." However, the measurement sections of the Proposed Update are silent with respect to whether and entity should discount cash flows when measuring the amount that it expects to collect or pay.

The Board also should consider clarifying Proposed Update 205-30-30-3 by explicitly stating whether "other costs and income" recognized in the initial measurement would include all costs to liquidate the entity, including costs that the entity would have incurred even without liquidating, or whether only the incremental costs of liquidating would be included. There is currently diversity in practice about whether entities should accrue ongoing costs of operating an entity (including, for example, audit fees) in liquidation basis financial statements.

Presentation

When referencing the other statements that may be presented, the phrase "at a minimum" in Proposed Update 205-30-45-1 should be removed or clarified. It is unclear what other statements could or should be presented.

The Board should clarify whether any financial statements for the prior year, or the stub period prior to the date that liquidation became imminent, would be required or permitted to be prepared and, if so, whether those financial statements would be presented under the going concern basis or the liquidation basis. Given that the proposed update would require liquidation basis financial statements from the date at which liquidation becomes imminent, it would seem inappropriate and inconsistent with the proposal to present comparative period financial statements on the liquidation basis.

The Board should consider clarifying whether the statement of net assets in liquidation should be classified between current and non-current assets. Given the significant unpredictability during the liquidation process of when an asset will be liquidated or when a liability will be settled, we recommend that the statement of net assets in liquidation be presented on an unclassified basis.

Proposed Update 205-30-25-4 requires that liquidation basis accounting be applied prospectively from the day that liquidation is imminent with a cumulative-effect adjustment. Users of liquidation basis financial statements may find it helpful if liquidating entities disaggregated the cumulative-effect adjustment into its components, either on the face of the statement of changes in net assets, or in the notes. For example, users might find it helpful if the cumulative-effect adjustment were disaggregated into the following items:

- ▶ Adjustments to assets and liabilities to the amounts expected to be collected or paid
- ▶ Accruals of estimated costs to dispose of assets or liabilities
- ▶ Accruals of other costs and income expected to be incurred or earned
- ▶ Assets written off upon adopting the liquidation basis of accounting

To help promote consistency in application, the Board should consider including examples of a statement of net assets in liquidation and a statement of changes in net assets in liquidation in the Proposed Update.

Practical issues for employee benefit plans

We also are concerned that the guidance may not be clear for defined contribution, defined benefit and health and welfare plans, particularly if the Board retains its view that the liquidation basis guidance is incremental to other guidance in US GAAP. Additional guidance and/or examples would help promote consistent application.

For example, the financial statements of a defined contribution plan include a statement of net assets available for plan benefits. The obligation related to participant accounts is not reflected as a liability in the statement of net assets available for plan benefits. Since the Proposed Update would require a statement of net assets in liquidation, it is not clear whether a liquidating defined contribution plan would continue to present a statement of net assets available for plan benefits. It is also not clear whether the statement of net assets in liquidation should reflect a liability for the benefits payable for the participant accounts, and if so, how that amount should be measured.

Similarly, the financial statements of a defined benefit plan include a statement of net assets available for benefits, and a statement of accumulated plan benefits. The obligation related to accumulated plan benefits is not reflected in the statement of net assets available for plan benefits. Since the Proposed Update would require a statement of net assets in liquidation, it is not clear whether a liquidating defined benefit plan would continue to present a statement of accumulated plan benefits or a statement of net assets available for benefits. It is also not clear whether the statement of net assets in liquidation should reflect a liability for the accumulated plan benefits.

If a liquidating defined benefit plan does present accumulated plan benefits, the measurement of that amount is not clear. Under the going concern basis of accounting, most defined benefit plans present the accumulated plan benefits as of beginning of the year, which is allowed under ASC 960. Retaining ASC 960-40-35-2 implies that some of the guidance within ASC 960 still applies under the liquidation basis of accounting and that the accumulated plan benefit obligation could still be presented as of the beginning of the year. However, this would seem to conflict with Proposed Update 205-30-30-1, which requires measurement of liabilities to be based on the amount expected to be paid.

Question 3: The proposed guidance would apply to all entities that prepare financial statements in accordance with U.S. GAAP. Should the proposed guidance differ for any entities (for example, investment companies) whose primary measurement attribute is fair value? If so, why?

We agree that the scope of the Proposed Update should apply to all entities, and that there should not be different guidance for any entities whose primary attribute is fair value, such as investment companies or defined contribution plans.

In practice, many investment companies have limited lives, liquidate according to their original plans, and would not prepare liquidation basis financial statements. However, if an investment company does not have a limited life or if it liquidates in a manner different from that established at inception, we agree with the Board that such an entity should apply the liquidation basis of accounting. In this circumstance, we believe that the investment company should make the users of its financial statements aware that it is no longer a going concern, even if it will dispose of its assets in orderly transactions.

However, consequential amendments may be necessary to ASC 946 *Financial Services - Investment Companies*, or any newly issued guidance resulting from the Investment Companies project, because ASC 946 currently requires investment companies to measure their assets at fair value. Without amendment, there would appear to be a conflict between the measurement basis required by ASC 946 and that required by this Proposed Update for an investment company for which liquidation is imminent. If the Board retains its view that the liquidation basis guidance is incremental to other guidance in US GAAP, other clarifying amendments also may be required to promote consistent application. For example, ASC 946 requires an investment company to present a statement of financial position, while the Proposed Update requires a statement of net assets in liquidation.

If the Board were to decide that the proposed guidance should not apply to all entities that prepare financial statements in accordance with US GAAP (for example, investment companies), defined contribution plans also should be excluded, since their primary measurement attribute is also fair value, and they have other similar attributes to investment companies.

Question 4: The proposed guidance would apply to a limited-life entity when significant management activities are limited to those necessary to carry out a plan for liquidation other than that which was specified in the entity's governing documents. Indicators have been provided to help an entity determine whether a plan for liquidation differs from that which was specified in the governing documents. Do you agree with the proposed guidance about when a limited-life entity should use the liquidation basis of accounting? If not, why?

Yes, we agree that a limited-life entity should not apply the liquidation basis of accounting if it carries out a plan for liquidation that was specified in its governing documents. However, certain clarifications are needed to ensure the standard is operational and applied consistently

Example 3 in the Proposed Update is clear that if a limited-life entity carries out a plan of liquidation consistent with its governing documents, liquidation basis financial statements are not required. However, this conclusion is not readily apparent in Proposed Update 205-30-25-3. We recommend adding: "If a plan for liquidation is specified in an entity's governing documents at its inception (e.g., a limited-life entity) and liquidation occurs as planned, the liquidation basis would not be applied in the entity's financial statements."

Proposed Update 205-30-25-3 also should be clarified to specify that liquidation is imminent when "all of the significant management decisions about furthering **all** of the ongoing operations of the entity have ceased..." Without this clarification, some might conclude that the liquidation basis of accounting is appropriate if only **a portion** of an entity (for example, a consolidated subsidiary) is being liquidated. That conclusion would be inappropriate because ASC 205 already provides guidance under the going concern basis of accounting when a portion of an entity is held for sale or discontinued. Furthermore, it also would be confusing to users of the financial statements if a portion of an entity (the consolidated subsidiary) was presented on the liquidation basis and the remaining entity was presented on the going concern basis. However, if the Board intends for the subsidiary's accounting to "roll up" to the parent's financial statements, that should be clarified in the final standard.

Question 5: The proposed guidance would apply to public and nonpublic entities (that is, private companies and not-for-profit organizations). Should any of the proposed amendments be different for nonpublic entities? If so, please identify those proposed amendments and describe how and why you think they should be different.

Generally, the guidance for preparing financial statements under the liquidation basis of accounting should be the same for all entities, regardless of whether they are public or nonpublic because the users of their financial statements would have similar concerns.

However, there may be cases in which fewer disclosures would be appropriate for a nonpublic entity.

Other comments

IFRS Convergence

The Board should clarify its conclusions on convergence with IFRS. BC11 of the Basis for Conclusions to the Proposed Update states: "This guidance will lead to financial reporting practices that are more comparable to those under IFRS." This seems to contradict BC7, which states that the Board specifically used a definition different from IFRS to "more clearly state" how and when an entity should apply the liquidation basis of accounting, and to deal with limited-life entities.

In addition, because IFRS does not provide any guidance on the preparation of financial statements using the liquidation basis of accounting, there is diversity in practice. It is unclear why the Board believes that the Proposed Update would converge with IFRS.

Dispositions in an orderly manner

We note that in BC9 of the Proposed Update, the Board states "assets and liabilities would be measured at the estimated amount of cash expected to be collected or paid. This measurement differs from fair value because it does not assume that the related dispositions would be conducted in an orderly manner; **in fact they likely would not**" (emphasis added). We support the measurement basis in the Proposed Update and we acknowledge that this amount might differ from fair value. However, we note that in an orderly liquidation the "amount of cash expected to be collected or paid" may equal fair value (for example, this may be the case when a defined contribution plan or an investment company is liquidating primarily financial assets).

Taxonomy

In reviewing the proposed taxonomy, we noted that the elements do not appear to address both the statement of net assets in liquidation and the statement of changes in net assets in liquidation for each of the three types of items measured in paragraphs 205-30-30-1 to 3. The table below illustrates the missing elements:

	Statement of net assets in liquidation	Statement of changes in net assets in liquidation
205-30-30-1 - Assets and liabilities shall be measured to reflect the estimated amount of cash or other consideration that an entity expects to collect or pay to carry out its plan for liquidation.	X (missing)	X (missing)
205-30-30-2 - Estimated costs to dispose of assets or liabilities shall be accrued and presented in the aggregate separately from the measurement of those assets or liabilities.	Yes - Liquidation Basis of Accounting, Accrued Costs to Dispose of Assets and Liabilities	Yes - Liquidation Basis of Accounting, Costs and Expenses to Dispose of Assets and Liabilities
205-30-30-3 - Other costs and income that an entity expects to incur or earn (for example, payroll expense and interest income) shall be accrued through the date at which the entity expects to complete its liquidation. See paragraph 205-30-50-1 for related disclosure requirements.	X (missing)	X (missing)

We are also aware that some entities that prepare their financial statements on a going concern basis use the term “net assets,” such as not-for-profit entities, employee benefit plans and investment companies. As a result, the “net assets” element introduced in the taxonomy should specifically refer to the liquidation basis of accounting to differentiate it from the element used in financial statements prepared for entities that are going concerns.

Finally, the element “net assets, adjusted balance” refers to prospective application of a new accounting principle. It is not clear whether this refers to the first-time adoption of liquidation basis accounting or to other new accounting standards. If it is the former, this should be clarified. As noted above, entities applying the liquidation basis of accounting should be exempt from applying accounting standards that become effective after liquidation becomes imminent.