



Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

233 N. Michigan Ave., Suite 2500
Chicago, IL 60601

October 1, 2012

Via email to director@fasb.org

Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

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

Dear Ms. Cospers:

We are pleased to provide comments on the proposal to establish authoritative standards for the liquidation basis of accounting. We agree guidance is needed to fill the void that currently exists in US GAAP, particularly in light of the recent economic downturn.

We also agree the liquidation basis of accounting should apply when liquidation is "imminent." We believe the Board's focus on ensuring the guidance is operational by adopting a notion that exists in the auditing standards and defining it based on relatively objective criteria should foster comparable application for most entities.

However, we fail to see a clear basis in the language proposed for limited-life entities. It states that "if a plan for liquidation was specified in an entity's governing documents at its inception..., then liquidation is imminent when significant management decisions about furthering the ongoing operations of the entity have ceased or they are substantially limited to those necessary to carry out a plan for liquidation *other than the plan specified at inception* (emphasis added)." This paragraph goes on to provide indicators of when a plan for liquidation might differ from that which was originally specified in the entity's governing documents.

We note the term of a limited-life entity may be shortened or extended to opportunistically acquire and dispose of assets. That scenario doesn't necessarily coincide with the shift in user needs that the Board contemplated in its deliberations.¹ While we agree that it is undesirable for limited-life entities to apply the liquidation basis of accounting from inception, we believe the final amendments should focus more specifically on the life cycle of the entity, which drives user needs. At the point in time when substantially all of the entity's activities are focused on the liquidation and distribution of existing assets, the liquidation basis should be applied regardless of the original plan in the entity's governing

¹ See paragraph BC8 in the exposure draft.



Technical Director
Financial Accounting Standards Board
Page 2 of 6

documents. To the extent the entity has reflected its assets at fair value and the distribution will be in an orderly fashion for consideration that is commensurate with the fair value of the assets, the implications of the liquidation basis of accounting should be minimal. Otherwise, adjusting the financial statements to reflect assets and liabilities at the amount of cash that is expected to be collected or paid should be a beneficial change for users—at the time it is most relevant.

We have provided additional responses to the questions posed in the exposure draft below.

* * * * *

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting at (312) 616-4667 or Adam Brown, Partner in the National Accounting Department at (214) 665-0673.

Very truly yours,

BDO USA, LLP

BDO USA, LLP



Technical Director
Financial Accounting Standards Board
Page 3 of 6

Appendix

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?

We believe the proposed guidance is appropriate and operational for most entities.

However, as discussed in our cover letter, we believe the threshold for applying liquidation basis to a limited life entity should focus more specifically on its life cycle. That is, the liquidation basis should apply at the point when substantially all of the entity's activities are focused on the liquidation and distribution of existing assets, regardless of the original plan. For example, this may occur when an investment manager commences liquidation and has communicated this intent to investors, irrespective of the entity's governing documents.

While our approach may be more subjective than focusing on whether an entity's governing documents have changed, we believe it is more closely linked to user needs. We note users of liquidation basis financial statements are focused almost exclusively on any remaining available funds to which they are entitled at final liquidation. Even if some level of diversity arises from practitioners reaching different interpretations as to when liquidation is imminent for limited life entities under our approach, it may be acceptable because those users would not be primarily concerned with comparing the reporting entity to other companies.

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 note paragraph 205-30-05-3 indicates that the accounting and reporting guidance proposed in the ED "is incremental to guidance that otherwise applies" to the reporting entity. This appears to conflict with the ED's initial and subsequent measurement guidance, for instance, the liquidation basis guidance appears to override Topic 815's requirement that derivative instruments are carried at fair value. We believe the liquidation basis measurement guidance is distinct from other GAAP, and that this should be clarified accordingly.

In addition, paragraph 205-30-30-1 refers to the amounts an entity expects to collect or pay. That notion seems to contemplate nonperformance risk in collections and payments, including the reporting entity's own credit risk as it relates to liabilities. For example, the reporting entity may not have funds sufficient to satisfy the total amount of its liabilities,



Technical Director
Financial Accounting Standards Board
Page 4 of 6

such as a reporting entity in bankruptcy where the amount of allowed claims exceed the expected settlement amount. If our understanding is correct, we recommend clarifying this concept in the final amendments. We note our view is corroborated by the proposed disclosure of “discount rates used” in paragraph 205-30-50-1(c). Further, the Board may consider providing guidance on when discounting is appropriate, such as whether the effect of discounting is expected to be significant, and/or whether the payment stream is fixed and determinable.

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 the proposal should apply to all entities. As noted above, we would not generally expect the usefulness of an entity’s financial statements that report assets at fair value (such as an investment company) to be negatively affected by liquidation basis treatment, assuming liquidation is imminent.

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?

See our response to Question 1.

If the Board does not adopt our recommended changes, we offer the following observations related to paragraph 205-30-25-3:

- The notion of “ongoing” operations would need to be better defined. It appears to consist solely of activities involved in managing the business/assets prior to the actual sale and disposition, activities normally associated with a going concern. If that understanding is correct, then liquidation would seem imminent in Example 3 at the end of year 8—the point at which management stopped making decisions related to managing and increasing the value of its investments. Otherwise, Example 3 provides counterintuitive guidance for planned liquidations. In that situation, assume management had to extend the life of the entity at the end of year 10 in order to complete its liquidation. User needs would presumably be the same in years 9, 10 and 11. However, users would only receive liquidation basis financial reports for year 11.
- The indicators that a plan for liquidation might differ from the original governing documents do not seem to correspond with the two criteria for concluding whether liquidation is “imminent.” For example, if only plans that have been altered will qualify for liquidation basis, why would disposal in a manner that is not orderly or for



Technical Director
Financial Accounting Standards Board
Page 5 of 6

consideration not commensurate with the fair value of the assets be relevant if the original governing documents contemplated a distressed sale?

- The proposed language refers to management “decisions” having ceased as a condition for applying liquidation basis. However, Example 2 states that the liquidation basis applies at the point that the entity’s significant management “activities” became limited. We note management decisions may be complete at a much earlier date than when the related activities are actually executed. To illustrate, the key decisions in a securitization vehicle are often established at inception, while the related business activities are carried out for a period of years thereafter.

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.

We believe the guidance should apply equally to public and nonpublic entities.

Other Comments:

- Paragraph 205-30-50-1 states that the proposed disclosures apply “in addition to all other disclosures required by US GAAP....” As noted in our comments on the proposed measurement guidance, we find such qualifying language confusing. For instance, if an entity that normally carries its asset at fair value adopts the liquidation basis without materially changing the recorded amount of its assets, would it continue to be appropriate to require all of the related disclosures in Topic 820? In this context, we note BC10 states that “an entity that measures its assets primarily at fair value would record adjustments that reconcile fair value to the amounts of expected recoverable cash as part of its accrual of estimated costs to dispose of assets and liabilities.” This seems to confirm that the assets in question are no longer technically subject to a fair value measurement attribute, rendering the related disclosures irrelevant. As such, we believe the language in BC10 should be elevated out of the basis for conclusions to the final amendments and paragraph 50-1 should be revised to more clearly indicate how the proposed disclosures interact with existing US GAAP.
- With respect to nonperformance risk in the reporting entity’s liabilities, we recommend disclosing the difference, if any, between what the entity expects to pay and what is contractually owed to counterparties. A similar disclosure for assets regarding the difference between amounts expected to be collected and contractually owed to the entity may also be useful.
- Subsequent to the period in which liquidation basis is adopted, we believe disclosure of the reasons for significant changes in estimates that affect reported amounts



Technical Director
Financial Accounting Standards Board
Page 6 of 6

should be required, e.g. significant “true-ups” should be explained to readers of the statements.

- We recommend including illustrative financial statements in the implementation guidance. We note most reporting entities do not routinely report a statement of net assets (or changes in net assets), unless they are subject to industry-specific guidance. We also observe that paragraph 205-30-45-1 indicates that two statements are required “at a minimum.” We believe it would help to provide further guidance regarding the circumstances in which additional statements are appropriate or required. This would include illustrating the financial statement presentation of adopting the liquidation basis of accounting in the middle of a period, i.e., an example of consecutive pre- and post-liquidation statements.
- For investment companies, additional guidance should be provided as to whether disclosing financial highlights would continue to be useful or appropriate.
- Lastly, we recommend providing guidance in the final standard addressing whether a parent should retain the liquidation basis of accounting for its consolidated subsidiary, assuming it is appropriate in the standalone statements of the subsidiary. Similarly, would a master fund’s adoption of liquidation basis trigger the same change in accounting for the related feeder fund?