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CERTIFIED PUBLIC ACCOUNTANTS

October 1, 2012

Technical Director  
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Financial Accounting Standards Board  
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We appreciate the opportunity to comment on the FASB's proposed accounting standards update, *Presentation of Financial Statements (Topic 205): The Liquidation Basis of Accounting*.

We support the FASB's efforts to issue guidance to clarify when an entity should apply the liquidation basis of accounting and to provide principles for the measurement of assets and liabilities under the liquidation basis of accounting as well as required disclosures.

Our recommendations and comments are summarized below:

**Comments related to Questions 1, 2 and 4:**

We believe the guidance in 205-30-25-2 and 25-3 would benefit from further clarification. Currently, we believe certain preparers and auditors believe that for liquidation to be imminent, it must occur in the relative near term (within one year). Because no time frame is referred to in the ED, the inference is that an entity may have to prepare its financial statements on the liquidation basis of accounting for several years before final liquidation occurs. Although I am supportive of such a position, the Board may wish to clarify its intent. For instance, in some cases a plan of liquidation may be adopted and implemented with cessation of all ongoing operations, but with the intent not to formally dissolve the entity and not to distribute remaining cash to owners for legal or other reasons.

Also, we believe the criteria for adopting the liquidation basis of accounting for limited-life and "perpetual-life" entities should be more consistent. That is to say, if the cessation of significant management decisions about furthering the ongoing operations of the entity is a relevant factor for a limited-life entity, why not for a perpetual-life entity? Conversely, for a limited-life entity to adopt the liquidation basis of accounting, why isn't the approval

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of a formal plan for liquidation a determinative factor? Accordingly, we would suggest applying 205-30-25-2 to both limited-life and perpetual-life entities but clarifying that a limited-life entity should not apply the liquidation basis of accounting so long as its actual liquidation is substantially consistent with the plan specified in its governing documents. We would further suggest clarifying that a single purpose perpetual-life entity (for instance a real estate entity without a limited-life formed to acquire, operate and ultimately dispose of a single property) would also not apply the liquidation basis of accounting provided the entity was not insolvent and the ultimate sale of the property and final distribution to owners was contemplated at the formation of the entity.

We believe the Board should provide guidance on implementing 205-30-30-3. For example, assume an entity that holds operating real estate. Assume that at the reporting date, the entity anticipates a holding period of up to two years for certain properties. Following 205-30-30-3, it appears the entity would be required to accrue expected rental income and related expenses through the expected holding period of the properties, and report the real estate at the amount of cash the entity expects to collect upon disposition (with separate accruals for costs to dispose of the real estate). If the objective is to report the amount of cash that would be available to investors after liquidation (see paragraph BC8), we would think that the amounts in this example would not be discounted. However, 205-30-50-1 refers to discount rates in discussing disclosure of methods and significant assumptions used to measure assets and liabilities. It seems to us that the expected amounts should not be discounted inasmuch as the objective is not to estimate the present value or the fair value of the real estate at the reporting date, but rather to estimate the expected cash available to investors from the disposition of the properties.

#### **Comments relating to Question 5**

We believe the proposed guidance should be the same for nonpublic and public entities.

#### **Comments relating to Question 3**

Fair value is the primary measurement attribute for employee benefit plans that are expected to continue in operation; i.e., that are going concerns. Subtopic 40 of Topic 960 addresses liquidating plans and states that, "If the decision to terminate a plan is made before the end of the plan year, the plan's year-end financial statements shall be prepared on the liquidation basis of accounting....." Further, it is our understanding that



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the SEC considers financial statements to be false and misleading if they are prepared on the assumption of a going concern but should more appropriately be based on the assumption of liquidation. Accordingly, I believe that all entities, including those whose primary measurement attribute is fair value (including investment companies), should apply the proposed guidance in a consistent manner.

I have the following observations about the application of the liquidation basis of accounting to investment companies under current practice.

We believe it is not uncommon for perpetual-life investment companies to liquidate. As mentioned in the preceding paragraph, it is our understanding that the SEC considers financial statements to be false and misleading if they are prepared on the assumption of a going concern but should more appropriately be based on the assumption of liquidation. Perhaps for that reason, the “purported” use of the liquidation basis of accounting for investment companies appears to be fairly prevalent based on a search of the SEC’s EDGAR database. We refer to the “purported” use of the liquidation basis of accounting because in our experience almost all investment companies (both those that file financial statements with the SEC and those that do not) that adopt the liquidation basis continue to prepare their basic financial statements under the broad guidance of FASB ASC 205 (consistent with the presentation for going concerns) and continue to provide the fair value disclosures required by FASB ASC 820 and assert that the investments are measured in accordance with FASB ASC 820, even though they also assert that all assets are reported at their realizable values or amounts (which we believe represents or should represent the estimated amount of cash that the entity expects to collect). I find this puzzling since I believe that FASB ASC 820 is not the relevant measurement principle for an entity on the liquidation basis of accounting. That said, I acknowledge that in many if not most cases the liquidation value and fair value would not be materially different. However, I can think of several instances where the liquidation value may differ materially from fair value under FASB ASC 820.



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A somewhat straightforward example when the application of FASB ASC 820 would differ from the liquidation basis of accounting might involve level one securities. Consider the following:

Assume a large investment in a level one security that on a liquidation basis would have a material block discount or a material control premium. Assume that a contract is entered into at the reporting/measurement date to sell the security at a material discount from the market value or a material premium above market value (market value being the fair value based on unadjusted quoted prices). Assume the contract is not expected to close for several months after the reporting/measurement date. Under “going concern” accounting (i.e., FASB ASC 820) the quoted price must be used to report the fair value of the investment because FASB ASC 820 does not provide otherwise. (Whether or not the contract to sell the investment should or could be given separate recognition in the financial statements of an investment company that is a going concern is a separate issue). However, under the liquidation basis of accounting, if one reports the investment at the amount of cash expected to be received, the amount reported for the investment should reflect the contract price, assuming that amount is the best estimate of the amount of cash expected to be collected.

As another example, assume an investment company holds a portfolio of illiquid investments in private investment companies. Assume it would likely take up to five years for the reporting entity to redeem its investments at net asset value inasmuch as the investee entities are in liquidation and have imposed restrictions on redemptions. Assume that the reporting entity concludes a sale in the secondary market of all the investees in a bulk sale would be advantageous due to, among other reasons, market risks associated with holding the investments as well as the costs associated with holding the investments to redemption. Assume the reporting entity enters into a contract to sell all the investments in a bulk sale for 50% of their reported net asset value. The contract is entered into on or before the reporting date, however, it is not expected to close until up to six to nine months following the reporting date. If the reporting entity is in liquidation, I believe it would be appropriate to report the investments at the price(s) specified in the contract of sale. However, if the reporting entity is a going concern, I believe the proper accounting would be to report each investment at its fair value determined under FASB ASC 820, which values may be materially different than the prices specified in the contract of sale. (As mentioned in the



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preceding paragraph, whether or not the contract to sell the investment should or could be given separate recognition in the financial statements of an investment company that is a going concern is a separate issue.)

### **General Comments**

We are not certain how the Board envisions 205-30-05-3 to be applied. A search of the Codification for the phrase “incremental to guidance” yields only a single instance, 852-10-05-2, which addresses the accounting and financial statement disclosure for entities that have filed petitions with the Bankruptcy Court and expect to reorganize as **going concerns** under Chapter 11 of the Bankruptcy Code. Since the Codification currently has no specific guidance on the liquidation basis of accounting, it is reasonable to assume that current authoritative GAAP was crafted primarily for going concerns. Accordingly, the phrase “incremental to guidance that otherwise applies to an entity” makes sense in the context of an entity that expects to reorganize as a going concern under Chapter 11, but not in the context of an entity that has adopted the liquidation basis of accounting (and which may have filed petitions with the bankruptcy court under Chapter 7 of the bankruptcy code).

We would suggest that either 205-30-05-3 be deleted or that it be clarified to explain how other sections of the Codification might or might not be applicable to an entity on the liquidation basis of accounting. Perhaps something similar to the following should be considered:

The guidance in other sections of the Codification may or may not be relevant to an entity preparing its financial statements on the liquidation basis of accounting. Such guidance may (should) be considered; however, whether or not a reporting entity chooses to follow such guidance depends on its exercise of judgment consistent with its specific facts and circumstances.

We don't understand the rationale underlying the following sentence in BC9 and believe it should be deleted.

“An entity that measures its assets primarily at fair value would record adjustments that reconcile fair value to the amount of expected recoverable cash as part of its accrual of estimated costs to dispose of assets and liabilities.”



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If something needs to be said, we suggest:

“An entity on the liquidation basis measures its assets at the amount of expected recoverable cash.”

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The views expressed herein are those of the author and do not necessarily reflect those of Margolin, Winer & Evens LLP.

Please contact Michael Peress at (516) 240-4227 if you have any questions regarding these comments.

Very truly yours,

A handwritten signature in blue ink that reads "Michael Peress". The signature is written in a cursive, flowing style.

Michael Peress, Partner