



**Association for
Financial Professionals**



LETTER OF COMMENT NO. |

July 19, 2006

Mr. Robert Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: FAS-95 and the Definition of Cash Equivalents

Dear Mr. Herz:

The Association for Financial Professionals (AFP) strongly urges the Financial Accounting Standards Board (FASB) to consider revising Financial Accounting Standards-95 (FAS-95) in order to provide clarification for cash and cash equivalents. As currently written, FAS-95 is not responsive to today's markets and fails to recognize today's investment infrastructure. Further, this lack of clarity in FAS-95 has allowed an accounting firm with no regulatory authority to unilaterally reinterpret the standard with no oversight or due process.

The membership of AFP represents approximately 15,000 finance and treasury professionals employed by over 5,000 corporations and other organizations. Our membership includes a significant number of corporate treasurers who oversee the management and investment of cash, short-term and long-term investments.

Background

In February 2005, PricewaterhouseCoopers (PwC) issued an advisory indicating that Auction Rate Securities (ARS) that have been commonly accounted for as a cash equivalent no longer qualified for this treatment and should now be considered a short-term investment. The other three CPA firms, which along with PwC make up the "Big-4," followed suit. In its advisory, PwC opined that since the securities underlying ARS had durations longer than 90 days, ARS could not be considered cash or cash equivalents. This interpretation ignores the significant liquidity protection and risk mitigation built into the ARS market system.

The immediate and unilateral change by the "Big-4" firms in the accounting for ARS caused companies to modify current financial statements (balance sheet and cash flow statements) and to restate prior financial statements. Further, companies were forced to

quickly modify cash strategies and review debt covenants with cash and cash equivalent compliance requirements. This change in the accounting treatment of ARS introduced instability into the capital markets and made it appear to the public that companies had done something improper.

A year later, in March 2006, PwC issued a document applying the same narrow logic they used regarding ARS to Variable Rate Demand Notes (VRDN). Again, this advisory said that VRDN no longer qualified as a cash equivalent on the balance sheet even though these investment vehicles did not change in character and were always considered as a cash equivalent based on generally accepted principles. This unilateral decision, with no due process, proceeded in much the same way as PwC's decision on Auction Rate Securities. In both cases, all four accounting firms followed suit at the same time.

Variable Rate Demand Notes like Auction Rate Securities exist within a risk adjusted infrastructure that pre-sets interest and presents an insignificant level of risk. The established market, the setting of interest rates for a specific period of time and the participation of major investment banks as auction agents¹ enhances and redefines the risk and liquidity of the ARS system beyond the narrow limits of determining classification solely on the underlying long-term security. After the release of their order against broker-dealers on May 31, 2006,² SEC staff noted that brokers commonly participated in the Dutch auction to make sure the auction did not fail. This additional market-based infrastructure was completely ignored in both advisories issued by PwC. In addition, VRDN have a 'put' in place insuring the price of the investment. It is evident from the advisories that PwC intentionally avoided addressing the auction rate infrastructure and its risk mitigation.

On June 6, 2005, AFP asked FASB to look into the change in accounting treatment of ARS by the Big-4. On October 5, 2005, the Financial Accounting Standards Board meeting included an agenda item to discuss FAS-95 and Auction Rate Securities. The discussion concluded that FAS-95 does lack clarity, particularly related to ARS. Some board members, including the chairman, recommended that a project be entertained to address this issue. However, the decision was made to table the issue subject to a reallocation of resources.

The Impact on Corporate Treasury

For the second time in two years, without prior notification, companies were required to modify current financial statements (balance sheet and cash flow statement) and to restate prior financial statements under threat by their external auditor. Notice of this change was not received by the company until February or later, after the auditor had begun the year-end work. This was the case for calendar year 2004 for auction rate securities and

¹ The Bank of New York, Deutsche Bank North American, Wachovia Bank NA, Wells Fargo Bank NA and Wilmington Trust Company. Source from the Bond Market Association.

² On May 31, 2006, the SEC released notice 2006-83, against Broker-Dealer Firms involving violative practices in the Auction Rate Securities Market.

was repeated for calendar year 2005 year-end work with variable rate demand notes. Once again, plans for managing cash were significantly disrupted. Debt covenants with cash and cash equivalent compliance requirements had to be reviewed to assure that there were no loan covenant violations. If there were covenant violations triggered by this change, they needed to be remedied by amendments to loan agreements or risk a technical default and the possible withdrawal of financing.

These decisions by PwC and absence of any engagement by the FASB created confusion and difficulty in financial comparability. Some auditors are continuing to allow ARS or VRDN to be classified as a cash equivalent if the amount is not material to the financial statements. These decisions and the way in which they were made have triggered significant uncertainty. Corporate treasurers are now asking if money market accounts can still be considered a cash equivalent or whether these accounts will be the next target. Like ARS and VRDN, the underlying securities supporting money market accounts may also exceed the three month bright line test contained within FAS-95, plus money market accounts have no maturity dates and there is no guarantee of a par-in par-out on these accounts either. When they ask their auditor for written clarification, even the auditors are reluctant in providing a written position on this matter.

FAS 95 Concerns

AFP does not suggest that FAS-95 necessarily needs fundamental revision. However, FAS-95 does utilize examples which may need updating to assist practitioners in better understanding what a cash equivalent should generally look like. FAS-95 was adopted in 1987 when it was assumed that traditional financial institutions were the only acceptable vehicle to hold cash and cash equivalents. As our market-based economy continually evolves, new and more complex investment products that provide added return at little additional risk are available to corporate treasurers. Examples or illustrations of one time period do not always fit properly at a later time.

Lack of Due Process in the Current Decision by PwC

AFP is not only concerned with the substance of the PwC Advisory on VRDN and ARS, but also with the policy question on how accounting standards and interpretations will be set in the future. Essentially, PwC changed the accounting treatment for both VRDN and ARS without any due process and without any opportunity for feedback on the possible impact of the change. Further, the changes were made immediately and retroactively. While PwC will argue that it did not set a new standard, but only changed an interpretation, the impact of this change was as significant to the way corporations operate and particularly to AFP members as any new accounting standard. AFP believes that it is important to have one authoritative source of standards for financial accounting and reporting and that FASB is that source.

The process surrounding the change in accounting treatment for both VRDN and ARS was in direct contrast to the procedures followed by FASB in adopting new or amended rules. Generally, FASB issues an exposure draft with a comment period to allow interested parties to comment on the effectiveness and impact of the proposal. In

addition, the comment period and future effective date allows companies time to plan for accounting changes.

As FASB pursues convergence with the International Accounting Standards Board (IASB) to establish principles-based (objectives-based) standards, the power of the "Big-4" accounting firms becomes even more troubling. While broad based objective standards at the global level contribute to the establishment of a consistent framework, it also creates gaps in the application of the standards as they apply to myriad economic and transactional situations. We are extremely concerned that a non-regulatory, for-profit organization with inherent conflicts of interest can make unilateral accounting interpretations. This type of system risks market disruption and creates a tainted process.

Summary

The change in the accounting treatment of ARS and VRDN has had a tremendous impact on our membership. AFP believes that variable rate demand notes and auction rate securities, provided they are not subject to liquidity risks or other circumstances, should qualify as cash equivalents. We do not see where a compelling case has been made that VRDN or ARS represent a liquidity risk. We are also concerned that if FASB does not act, we will see this narrow interpretation extended to money market accounts.

Finally, we are concerned about the lack of due process and de facto standard setting. Accounting changes should not come from a private sector audit company to satisfy its own interests and with no opportunity for public comment.

In light of the recent action by PwC on VRDN, AFP strongly urges FASB to reverse its October 2005 decision to table discussion of FAS-95 and consider issuing additional clarification of FAS-95 to make the standard more responsive to today's markets.

Please contact John R. Rieger, Director of Accounting and Financial Reporting for any additional information or questions at (301) 961-8885 jrieger@afponline.org.

Sincerely,



James A. Kaitz
President and CEO
Association for Financial Professionals