

Response to invitation to comment on File Reference 2012-220

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**Re:** File Reference No. 2012-220

Regarding the questions beginning at Paragraph 2.18, *Information about Other Events and Conditions That Can Affect an Entity's Prospects for Future Cash Flows*.

A key consideration for investors over the last ten or fifteen years has been the undisclosed risks that can lead to catastrophic failure of entities holding substantial investments in financial instruments. Two cases illustrate these types of risks: Lehman Brothers, which was so exposed to the market that an unexpected downturn in real estate prices destroyed the company; and Knight Capital Group, which suffered a catastrophic failure of trading systems. Current U.S. GAAP and the proposals for disclosures starting at Paragraph 2.18 do not make sufficient allowance for informing investors of these kinds of risks.

Here is a suggested question:

Question: Is sufficient future cash flow of the company so exposed to market risk that an abnormal change in the markets could threaten the company's ability to continue as a going concern? If so, the following disclosures may be appropriate to inform investors and creditors of the risks borne by the company:

- a. The nature of the markets (e.g., stock market, commodities market, real estate market) that could substantially damage the company if they were to change in an abnormal way;
- b. The range of changes in those markets that would have to occur to threaten the company as a going concern;
- c. The potential harmful effects of failures in the company's internal trading systems, such as automated trading systems; and
- d. The results of the entity's testing of systems aimed at monitoring and controlling market risk.

As to the last item, an entity that is subject to substantial market and trading risk must consider internal information systems associated with controlling that risk as part of its system of internal

control over financial reporting (ICFR). ICFR is concerned with insuring that financial statements are free from material misstatement. Systems used to control an entity's exposure to market and trading risk represent key aspects of ICFR. Any entity should have robust systems to control risk, and explicit information about testing of those systems is important information for investors. If an entity does not have effective systems for controlling market and trading risk, then it has no way of insuring its ability to continue as a going concern, and its financial statements, as a whole, would be misstated if they are reported on a going concern basis.

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David Hardesty is an Adjunct Professor at Northeastern University College of Business Administration, and an Adjunct Professor at Golden Gate University's Graduate School of Taxation. David Hardesty is the author of the following books, all published by the Tax and Accounting Business of Thomson Reuters:

- Electronic Commerce: Taxation and Planning, (Warren Gorham & Lamont / Thomson-Reuters) (1,500 pages). This text, which is the leading authority on taxation of electronic commerce, is updated by David Hardesty every six months. The latest update was November 2011.
- Practical Guide to Corporate Governance and Accounting: Implementing the Requirements of the Sarbanes-Oxley Act, 2002, 2004, 2005, 2007, 2008, 2009, 2010, 2011 Editions (Warren Gorham & Lamont / Thomson-Reuters)
- Corporate Director's Deskbook (co-author), 2005, 2006, 2007, 2008, 2009, 2010, 2011 Editions (Warren Gorham & Lamont / Thomson-Reuters)
- SEC Expert: Domestic Filers (co-author) – this is an online service that is updated weekly (Thomson Reuters, Checkpoint)
- Choice of Entity – Title 1 of RIA Tax Advisors Planning System (Thomson Reuters, Checkpoint)
- Taxation of Electronic Commerce – Title 43 of RIA Tax Advisors Planning System (Thomson Reuters, Checkpoint)
- Accounting for Stock Compensation (Warren Gorham & Lamont / Thomson Reuters, 2010).