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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, *Disclosures about Liquidity Risk and Interest Rate Risk* (File Reference No. 2012-200)

Dear Ms. Cospers:

We are pleased to provide comments on the proposed disclosures for liquidity and interest rate risk. We agree with the Board that there are limits to the amount of information that can be conveyed to users solely through the primary financial statements. Footnote disclosures provide important context for those figures, as well as additional information that's not otherwise apparent.

We believe the proposed disclosures generally reflect that objective, but will not be as useful as they could be without a number of significant changes. For example, the liquidity gap table assumes that the only change to a financial institution's balance sheet is the maturity of its financial instruments. While this might standardize disclosures across banks, it is not realistic. Financial instruments are originated, sold, refinanced and transferred on a regular basis. In other words, the balance sheet "churns" as banks manage their asset/liability position, but that dynamic will not be meaningfully captured in the table.

Other companies that are not financial institutions will face many implementation questions when they prepare the cash flow obligations table for the first time, particularly private companies. Public companies and their auditors have addressed most of these questions over the past few years related to the SEC's contractual obligations table. We believe the Board could pre-empt diversity in practice in the cash flow obligations table by drawing on the experience of public companies and providing additional implementation guidance in the final amendments.

Lastly, we note the proposed liquidity and interest-rate risk disclosures were developed in the context of the going concern project. We agree that these businesses risks are particularly relevant as uncertainty grows about the reporting entity's ability to continue as a going concern. Since the Board has decided to revisit the going concern project, it might be advisable to coordinate its timing with this exposure draft. Whether going concern is ultimately addressed as a separate ASU or not, it seems the Board would be better



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positioned to finalize the liquidity and interest-rate risk disclosures in tandem with going concern. We also observe that the disclosure framework discussion paper introduces the notion of scaled, or tiered, disclosures based on the reporting entity's particular facts and circumstances. A "sliding-scale" notion could be a reasonable approach for deciding whether the proposed disclosures in this exposure draft would be more relevant if they were required as warranted by the circumstances, rather than in all cases.

* * * * *

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

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Appendix

Note: We have responded to questions posed to auditors.

Question 1: For a financial institution, the proposed amendments would require a liquidity gap table that includes the expected maturities of an entity's financial assets and financial liabilities. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

Our experience auditing community and regional banks indicates some of the assumptions necessary to prepare the table will be difficult to verify. This has been affirmed in recent informal discussions with bankers about the exposure draft. While larger institutions may have sufficient historical data to predict their customers' behavior, smaller institutions don't necessarily maintain the same information in a format that lends itself to preparing the liquidity gap table. For example, a community bank would need to make significant assumptions about the future borrowing and repayment of revolvers, letters of credit, etc. In addition, if a bank expects to sell an instrument prior to contractual maturity, the exposure draft states that expectation should be disregarded.¹ Despite having little to no visibility into the eventual settlement of a loan when held by a third party, the bank would be required to estimate the loan's maturity. It is not clear how an auditor would verify such assertions even though financial institutions are able to make them.

We are not certain these difficulties will be cost beneficial. The liquidity table is built on assumption of each instrument's maturity. Outside of a final liquidation, banks do not typically assume the composition of its portfolio will freeze, with changes only occurring due to maturities. For example, the exposure draft states prepayments should be considered in the liquidity table for loans that exist at the balance sheet date. A loan is often prepaid in order for the borrower to refinance, but the table does not contemplate a new loan. Similarly, the estimated run-off rate of a deposit is not particularly meaningful without the corresponding receipt of new deposits. As such, a "snapshot" based on a static asset/liability mix is not a realistic signal of a bank's anticipated liquidity. Since most banks do not forecast on a static basis, this table will require additional effort solely to comply with an accounting standard.

In addition, the required narrative disclosure that accompanies the table to "provide users of financial statements with an understanding of [the financial institution's] exposure to liquidity risk²" would likely draw attention to the fact that its actual asset/liability management is not consistent with the static nature of the table. This could cause confusion for users.

Lastly, paragraph 825-10-50-23B states that the liquidity risk disclosures apply to reportable segments as defined in Topic 280. This could require extensive effort on the part of private financial institutions that are not required to apply Topic 280 or to determine reportable segments. Although such entities identify operating segments in connection with goodwill impairment assessments, they have no current requirement to perform aggregation tests to

¹ Paragraphs 825-10-50-23E and 825-10-55-5A in the ED

² Paragraph 825-10-50-23J in the ED



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identify reportable segments. Going one step further, combining reportable segments would contradict current GAAP and call into question the value of disclosing reportable segments separately.

As discussed below, we believe the repricing table provides a more useful and realistic tool for assessing a financial institution's asset/liability management. The Board might reconsider whether users would be adequately informed based on the remaining disclosures in the proposal, without also requiring the liquidity gap table for financial institutions.

Question 2: For an entity that is not a financial institution, the proposed amendments would require a cash flow obligations table that includes the expected maturities of an entity's obligations. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

We believe the cash flow obligations table will provide useful disclosure, but that the following improvements are necessary.

Initially, the final ASU should confirm whether an entity's "expected financial cash flow obligations" equal the sum of its "financial liabilities and off-balance sheet obligations." If not, clarification would be needed. The term "off-balance sheet-obligations" should also be defined, including guidance for determining a cash outflow date, which may be highly subjective in certain cases. These obligations presumably include operating lease payments, but the exposure draft is silent about other contracts. For example, should employment contracts, share-based payment transactions that may be settled in cash, and union contracts be included? If so, the amount of expected settlements in the table may differ from the amounts recognized in the financial statements for these contracts, based on the applicable measurement attributes. Similarly, would the "expected financial cash flow obligation" of a recognized contingent liability (e.g., litigation) be the same as the "best estimate" measured under ASC 450-20-30-1?

With respect to the periods presented in the table, we note they differ from other forward-looking disclosures, such as the five-year maturities of debt and capital leases. Additional effort will be required to provide maturity information for the same instruments, but in greater detail and for different periods. This could be confusing for users who attempt to relate the new disclosures to those that are already required. The Board should consider whether that situation is a desirable outcome.

In addition, "financial liabilities" could be read by practitioners to include the following items, based on the current definition in the Master Glossary:

- Accounts payable
- Certain accrued liabilities
- Deferred tax liabilities
- FIN 48 liabilities
- OPEB liabilities

However, we note the example provided in the exposure draft excludes all of these, even though financial liabilities would be required by paragraph 825-10-50-23M.



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Moreover, guidance for the year by year amounts of the following items would be needed:

- Interest on variable rate debt - should an entity use the rate as of the latest balance sheet date or the rate expected to be in effect for each period? What about any related interest-rate swaps?
- Contributions to defined benefit pension plans - Should an entity assume that plan assets will earn a rate of return equal to a high quality bond, or different short-term assumptions that might be more accurate?

Example 6 reflects “commitments” and “purchase obligations” separately. This implies a distinction that we believe needs to be clarified. It is also not clear why commitments qualify as cash flow obligations, particularly when they likely do not meet the definition of a liability, which underscores the need for a definition of off-balance sheet obligations.

Lastly, ASC 825-10-50-23Q requires a discussion of significant changes related to the timing of obligations and available liquid funds. The final standard should clarify which periods are to be compared to determine whether there has been a significant change requiring disclosure. For example, in the third quarter interim financial statements, is the intended comparison to (a) the end of the preceding quarter, (b) the end of the preceding fiscal year, (c) the end of the comparable quarter of the prior year, (d) or some or all of these dates? The most relevant discussion of changes may be to compare the end of the preceding fiscal year to the date of the most recent interim balance sheet, similar to S-K 305(b). Further, the ASU should state whether the approach to be used in annual and interim financial statements is the same, or not.

As the Board is aware, the SEC considered similar issues in connection with Releases 33-8144³ and 33-8182.⁴ The final rule reflected several changes compared to the initial proposal. For example, the SEC’s rule specifically defined off-balance sheet obligations to exclude routine arrangements that could obscure more meaningful information, and that such obligations should only be disclosed if they are “reasonably likely” to have a current or future effect. Given the uncertainty of such exposures, the Board may consider adding a similar threshold for including them in the cash flow obligations table, or addressing them through a narrative discussion as the SEC did instead of a tabular format. In addition, the final rules excluded contingent liabilities and commitments, concluding that a tabular format would inevitably omit important information about the operative facts and circumstances for those exposures. Therefore, we recommend further evaluating the SEC’s rulemaking efforts and how practice has developed since then before finalizing the proposed ASU.

Question 3: The proposed amendments would require information about expected maturities for financial assets and financial liabilities to highlight liquidity risk. *Expected maturity* is the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than an entity’s expected timing of the sale or transfer of the instrument. Do you agree

³ *Disclosure in Management’s Discussion and Analysis About Off-Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments*

⁴ *Disclosure in Management’s Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Obligations*



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that the term *expected maturity* is more meaningful than the term *contractual maturity* in the context of the proposed liquidity risk disclosures? If not, please explain the reasons and suggest an alternative approach.

We agree disclosures based on expected maturity would be more meaningful than contractual maturity. As indicated in our response to Question 1, we believe expected maturities should contemplate asset sales instead of disregarding them.

Question 4: The proposed amendments would require a quantitative disclosure of an entity's available liquid funds, as discussed in paragraphs 825-10-50-23S through 50-23V. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

The proposal in paragraph 50-23U calls for a narrative discussion of "the effect" of tax and repatriation conditions that limit the transferability of funds. We recommend clarifying (perhaps through an example) whether "the effect" includes quantifying the potential tax liabilities associated with repatriation, or simply noting the amount of funds that would be subject to tax. We note companies that do not accrue deferred taxes on undistributed earnings often find it difficult or impracticable to compute the amount of the deferred taxes for disclosure purposes.⁵ That situation suggests the benefit of the disclosure proposed in paragraph 50-23U could be limited. If it is ultimately adopted and tax calculations are required, we recommend qualifying this requirement with the practicability language that currently exists in Topic 740.⁶

Paragraph 50-23T states "an entity's borrowing availability *might include* loan commitments and other lines of credit (emphasis added)." The Board should consider using more definitive language, such as "borrowing availability under existing contracts at the balance sheet date." Otherwise, the exposure draft could be read to contemplate *potential* lending arrangements, such as borrowing term sheets that have not been fully executed.

Paragraph 50-23V describes (rather than defines) the concept of "high quality" liquid assets. We believe this could result in diverse conclusions across entities. Further, we are not convinced the distinction between "high quality" and lower quality liquid assets is necessary. We note other disclosures, such as those required by the recent credit quality ASU, as well as the existing fair value hierarchy in Topic 820, provide users with ample information about the risk of nonperformance for such assets.

In addition, it is not clear why two separate line items are reflected in Example 7 related to credit facilities (ABC vs. XYZ). We note "credit facility" is singular in the first line, while "credit facilities" is plural in the third line. Perhaps these items are intended to reflect the impact of restrictions on available funds that affect different entities within the consolidated group? If so, adding numbers to the table would help clarify.

⁵ ASC 740-30-50-2(c)

⁶ Ibid



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Question 5: For depository institutions, the proposed Update would require a time deposit table that includes the issuances and acquisitions of brokered deposits during the previous four fiscal quarters. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

In the exposure draft, Example 8 distinguishes between “insured” and “uninsured” time deposits. We note that the amount of coverage available for insured accounts varies based upon a number of factors, as illustrated in the following example:⁷

Example 7				
Insurance coverage for a family of four with deposit accounts in multiple ownership categories				
Account Title	Account Ownership Category	Owner (s)	Beneficiary (ies)	Maximum Insurable Amount
Husband	Single Account	Husband		\$ 250,000
Wife	Single Account	Wife		250,000
Husband IRA	Certain Retirement Account	Husband		250,000
Wife IRA	Certain Retirement Account	Wife		250,000
Husband & Wife	Joint Account	Husband & Wife		500,000
Husband POD	Revocable Trust Account	Husband	Wife	250,000
Wife POD	Revocable Trust Account	Wife	Husband	250,000
Husband & Wife Living Trust	Revocable Trust Account	Husband & Wife	Child 1 Child 2	1,000,000
Total				\$3,000,000

Since deposit balances vary and may exceed the available insurance limits, financial institutions may reach different conclusions as to whether to classify an entire deposit as “insured” or “uninsured,” or if the amounts on deposit in a single account should be allocated to each category. Additional implementation guidance on this point would be helpful.

Question 13: The interest rate risk disclosures in this proposed Update would require a repricing gap table. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

⁷ Reproduced from <http://www.fdic.gov/deposit/deposits/insured/faq.html>.



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Generally, we believe this table will be operational. However, initially, smaller financial institutions may not be familiar with the specific concept of “duration” or methods used to calculate it. In addition, Example 9 includes a section for “Interest-bearing financial liabilities.” It appears to have an erroneously titled subtotal, “Total interest-*earning* liabilities” which should refer to “interest-bearing” items. The same is true for Example 10.

Question 14: The interest rate risk disclosures in this proposed Update would include a sensitivity analysis of net income and shareholders’ equity. Do you foresee any significant operational concerns or constraints in determining the effect of changes in interest rates on net income and shareholders’ equity? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

Paragraph 825-10-50-23AD describes a sensitivity analysis related to shareholders’ equity that “shall reflect the measurement attributes used in the statement of financial position.” The paragraph goes on to distinguish between instruments that are carried at fair value through earnings (Category 1), and those that are not (Category 2).

For the specified interest rate sensitivity calculations, the full fair value change of Category 1 instruments is required to be reflected in the sensitivity analysis of shareholders’ equity. In addition to interest-rate risk, this would include credit and liquidity risks, among others. Operationally, this will require preparers to develop assumptions about the correlation between interest and other types of risk (such as prepayments), which will be subjective and difficult to quantify. It also appears conceptually inconsistent with the objective of the table, which the Board stated is designed to “present the effects of *interest rate changes* on net income and shareholders’ equity (emphasis added).”⁸ Given that principle, it would more useful to base the sensitivity calculation solely on interest rate changes, regardless of the measurement attribute that applies to the related financial instrument. This would simplify the assumptions that would be needed to prepare the table. It would also improve its comparability for users.

Beyond this point, the benefit of the shareholders’ equity sensitivity analysis is not readily apparent. GAAP equity must be adjusted under various prudential oversight regimes to assess the adequacy of regulatory capital. Whether shareholders’ equity is adjusted for interest-rate changes only or the complete change in fair value resulting from interest-rate volatility, neither outcome will substitute for regulatory reporting purposes. If the Board’s objective is broader than interest rate risk and prudential regulatory concerns, the basis for conclusions should more clearly explain the objective and how it drives the distinction between Categories 1 and 2 above.

Question 20: The amendments in this proposed Update would apply to all entities. Are there any entities, such as nonpublic entities, that should not be within the scope of this proposed Update? If yes, please identify the entities and explain why.

We believe the proposed disclosures will be useful for all entities, particularly in the context of uncertainties regarding an entity’s ability to continue as a going concern.

⁸ Paragraph BC 18 in the ED.



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As the FASB staff has acknowledged in the discussion paper on a private company decision-making framework, “a significant difference between most users of private company financial statements and those of public company financial statements is private company users’ direct access to management to obtain additional material financial information and analysis.”⁹ Since many community and regional banks are privately-held, the Board might wish to consider further outreach with their users, such as the small number of owners and directors that typically own the shares of a bank holding company. Their feedback may further inform the Board’s cost/benefit analysis of this project for such entities. Consultation with the Private Company Council might also help.

Question 21: Although the proposed amendments do not have an effective date, the Board intends to address the needs of users of financial statements for more information about liquidity risk and interest rate risk. Therefore, the Board will strive to make these proposed amendments effective on a timely basis. How much time do you think stakeholders would require to prepare for and implement the amendments in this proposed Update? Should nonpublic entities be provided with a delayed effective date? If so, how long of a delay should be permitted and why? Are there specific amendments that would require more time to implement than others? If so, please identify which ones and explain why.

We believe fiscal years ending after December 15, 2013 would be the earliest practical adoption date. This would allow adequate time for preparers and IT service providers to update their systems to comply with the new standard. In connection with the technology updates, management teams will need time to develop assumptions for expected maturities. A 2013 effective date will also provide a sufficient lead time for auditors to test the maturity assumptions, as well as the changes made to each company’s processes and information systems.

For more preparers with more sophisticated financial reporting systems, we believe the Board should allow early adoption to meet user needs.

Question 22: Do you believe that any of the amendments in this proposed Update provide information that overlaps with the SEC’s current disclosure requirements for public companies without providing incremental information? If yes, please identify which proposed amendments you believe overlap and discuss whether you believe that the costs in implementing the potentially overlapping amendments outweigh their benefits? Please explain why.

We believe the objectives in the ED and the SEC’s current disclosure requirements are quite similar. However, the ED is more prescriptive than the SEC guidance, and it relies more heavily on tables. A more standardized approach may provide an incremental benefit for users who make comparisons across companies. However, we’ve noted the following examples where the ED’s disclosures overlap to some degree with the SEC’s requirements:

⁹ Invitation to Comment: *Private Company Decision-Making Framework*, page 9.



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<u>Reporting Entity Type</u>	<u>Exposure Draft</u>	<u>Regulation S-K and Securities Act Guide 3</u>	<u>Comments</u>
All reporting entities	Available liquid funds table, with supplemental discussion	S-K 303(a)(1) requires discussion of liquidity and capital resources, which includes sources of liquidity, unused liquid assets and any restrictions on transfer.	The potential exists to duplicate much of the information presented in MD&A and the notes to the financial statements. However, if adjusted for our response to Question 4, we do not anticipate significant ongoing costs to prepare this table.
Nonfinancial institutions	Expected cash flow obligations table, with supplemental discussion	S-K 303(a)(5) requires a contractual obligations table, which may be accompanied by an explanatory narrative.	Smaller reporting companies are not required to provide the S-K 303(a)(5) disclosure. As such, users of their statements will receive incremental information. The periods specified in the ED and the use of expected maturity (instead of contractual maturity) will also provide additional information.
Financial institutions	Liquidity gap table, with supplemental discussion	S-K 303(a)(1) also requires a discussion of known trends and other events that are reasonably likely to affect liquidity.	Based on the prescriptive, static nature of the table in the ED, its disclosures may be less relevant than S-K 303, which provides more flexibility and may more accurately represent a financial institution's future liquidity position.



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<u>Reporting Entity Type</u>	<u>Exposure Draft</u>	<u>Regulation S-K and Securities Act Guide 3</u>	<u>Comments</u>
Financial institutions	Repricing gap and interest rate sensitivity disclosures, with supplemental discussion	<p>S-K 305 requires quantitative and qualitative information about market risks, which encompass (but are not limited to) interest rate risk. Registrants may select from three alternative approaches to provide the disclosures.</p> <p>Guide 3 requires a disclosure of variable and fixed rate loans, as well as interest-bearing and non interest-bearing deposits.</p>	<p>S-K 305 does not apply to smaller reporting companies or registered investment companies.</p> <p>Since the ED does not distinguish between different types of financial institutions for repricing and interest rate risk disclosures, the amount of additional information will be greater for some types of registrants than others.</p> <p>The ED's sensitivity disclosures are also more prescriptive than S-K 305.</p>
Depository institutions	Time deposits table	Guide 3 requires a disaggregation of deposits, but does not distinguish between insured and uninsured accounts.	Users will receive incremental information under the ED.