JULY 2, 2012

FASB In Focus

Proposed Accounting Standards Update (ASU), *Presentation of Financial Statements (Topic 205): The Liquidation Basis of Accounting*

The Financial Accounting Standards Board (FASB) on July 2, 2012, issued for public comment a proposed accounting standard that would clarify when and how an organization should apply the liquidation basis of accounting. The new standard would provide guidance for measuring assets and liabilities, as well as disclosures, when using the liquidation basis of accounting.

Liquidation occurs when a company is terminated and its assets are redistributed. After creditors are paid, shareholders receive what is left over. A company in liquidation ideally should use a basis of accounting that communicates how much it expects to be able to recover from its assets and pay to settle its obligations, with the remainder being available to return to its investors following liquidation. The proposed standard would provide guidance for when and how to apply this basis of accounting.

Why Is the FASB Proposing New Guidance?

Stakeholders have requested a standard that addresses when it is appropriate to apply, and how to apply, the liquidation basis of accounting. Current U.S. GAAP offers minimal guidance in this area. Consequently, there is diversity in practice in when and how companies and other organizations report using the liquidation basis of accounting. A new standard for the liquidation basis of accounting would improve the consistency and comparability of financial reporting.

What Is Being Proposed in This New Standard?

- ***A clear, consistent definition of the term "liquidation"***

  The proposed Accounting Standards Update (Update) would define "liquidation" as follows:

  "The process by which an entity converts its assets to cash or other assets and partially or fully settles its obligations with creditors in anticipation of the entity ceasing its operations. Any remaining cash or other assets are distributed to the entity's owners. Liquidation may be compulsory or voluntary. Dissolutions via acquisition or merger do not qualify as liquidations."

- ***Guidance about when a company or other organization should adopt the liquidation basis of accounting***

  The Board is proposing that companies or other organizations use the liquidation basis when liquidation is imminent. Liquidation would be considered imminent when either:

  » A plan for liquidation has been approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan would be blocked by other parties, or

  » A plan for liquidation is being imposed by other forces (such as involuntary bankruptcy) and the likelihood is remote that the company or organization will subsequently return from liquidation.

In some instances, a plan of liquidation is specified in the company or organization's governing documents. An example of a so-called "limited-life entity" is a partnership that is created specifically to complete a particular project. Upon completion of that project, the partnership is dissolved. Under the proposed standard, liquidation would be considered imminent only when management's decisions about furthering the ongoing operations of the entity have ceased or they are substantially limited to those necessary to carry out a plan of liquidation other than the plan specified at the inception of the entity.

- ***Guidance about how a company or other organization would apply the liquidation basis of accounting***

A reporting organization would be required to measure and present assets and liabilities in its financial statements at the amount of cash or other consideration that it expects to collect, or the amount of cash or other consideration that it expects to pay, during the course of liquidation. It also would be required to accrue and separately present costs that it expects to incur, and the income it expects to earn, during the expected duration of the liquidation. This would include any costs associated with the settlement of those assets and liabilities.

- ***Enhanced disclosures about the application of the liquidation basis of accounting***

  Disclosures would include the reporting organization's plan of liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation.

When Would the Amendments Be Effective?

The effective date would be determined after the Board considers feedback on the amendments in the proposed Update. The proposed amendments would be effective as of the beginning of the period of adoption and would be applied prospectively from the day that liquidation becomes imminent.

What Are the Next Steps in the Process?

The Exposure Draft is open for comment until October 1, 2012, and can be accessed at http://www.fasb.org.

How Does This Project Relate to the Board's Consideration of Going Concern Issues?

The Board's decision to develop a standard on the liquidation basis of accounting was made as a result of an earlier project to incorporate the AICPA's Codification of Statements on Auditing Standards AU Section 341, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AU 341), into U.S. GAAP. At that time, the Board was considering guidance that would require a reporting organization's management to evaluate its ability to continue as a going concern. A company that operates as a going concern is required to base its valuations and financial reporting on the assumption that it will continue to exist, and is not about to go out of business or be liquidated.

Following the comment period for its 2008 Exposure Draft, *Going Concern,* the Board modified the objective of the project to include guidance that requires a company or other organization to provide earlier disclosures (early-warning disclosures) as it becomes increasingly likely that the entity would be unable to meet its obligations as they become due. This objective replaced the project's initial objective of incorporating AU 341 into U.S. GAAP. Additionally, because several stakeholders indicated that the guidance about when and how a company or organization should apply the liquidation basis was inadequate, the Board added a separate objective to provide guidance related to that topic. After redeliberating these issues, the Board ultimately decided to revisit the objective of making management responsible for the going concern assessment.

Consequently, the Board decided that the Liquidation Basis of Accounting project would be the first phase of the project to consider these issues. The second phase of the project will consider management's responsibility for going concern assessments.

For more information about the project, please visit the FASB's website at www.fasb.org.

Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, Connecticut 06856-5116
T: 203.847.0700 | F: 203.849.9714