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October 1, 2012

Ms. Susan M. Cosper Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

File Reference No. 2012-210

Dear Ms. Cosper:

McGladrey LLP is pleased to comment on the Proposed Accounting Standards Update (ASU), *Presentation of Financial Statements (Topic 205): The Liquidation Basis of Accounting* (the "proposed ASU"). We support the efforts of the Financial Accounting Standards Board 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 any required disclosures. In that regard, we have included in this letter some overall comments, responses to the "Questions for Respondents" posed in the proposed ASU and other recommendations for consideration in finalizing the proposed ASU.

## **Overall Comments**

We agree that entities should prepare financial statements in accordance with the liquidation basis when liquidation is imminent. We also agree that liquidation is not imminent simply because a plan for liquidation was specified in the entity's governing documents at inception (e.g., limited-life entities). However, we believe such entities should also prepare financial statements in accordance with the liquidation basis when liquidation is imminent regardless of whether the plan for liquidation differs or is the same as that specified in its governing documents.

**Question 1:** The proposed guidance would require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent, as defined in the proposed guidance. Is the proposed guidance about when an entity should apply the liquidation basis of accounting appropriate and operational? If not, why?

We agree with the proposal to require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent as defined in paragraph 205-30-25-2 of the proposed ASU.

**Question 2:** The proposed guidance includes a principle for measuring assets and liabilities, as well as related items of income and expense, using the liquidation basis of accounting. The proposed guidance would require supplemental disclosures about the methods and assumptions used in arriving at those measurements. This guidance is intentionally nonprescriptive in light of the specialized nature of liquidation basis financial statements and the impracticability of providing prescriptive guidance for the myriad of circumstances to which it might apply. Is the proposed guidance on how to prepare financial statements using the liquidation basis sufficient and operational? If not, why?

We agree with the proposed measurement principles as well as the required disclosures about the methods and assumptions used in arriving at those measurements, but believe the following inconsistencies need to be addressed. Paragraph 205-30-35-1 uses the term "value" and

paragraph 205-30-50-1c refers to "discount rates used". However, ASC 205-30-30-1 indicates that assets and liabilities presented on the Statement of Net Assets in Liquidation should reflect the amount (presumably, undiscounted) of cash or other consideration expected to be collected or paid. If this is the case, we recommend the term "value" should be replaced with "amounts" and the phrase "and discount rates used" should be deleted.

**Question 3:** The proposed guidance would apply to all entities that prepare financial statements in accordance with U.S. GAAP. Should the proposed guidance differ for any entities (for example, investment companies) whose primary measurement attribute is fair value? If so, why?

We believe that when liquidation is imminent the liquidation basis of accounting should apply to all entities, including entities that report assets and liabilities at fair value in accordance with U.S. GAAP.

However, we believe terminating employee benefit plans should be specifically addressed in the proposed ASU due to their unique characteristics. Currently, a terminating plan goes to liquidation basis once the decision to terminate has been made and ASC 960, 962, and 965 does not provide much guidance on reporting and disclosure. The proposed ASU does not clarify the reporting and disclosure issues unique to terminating plans. Therefore, we recommend FASB consider the "other recommendations" outlined below and provide more guidance for employee benefit plans.

**Question 4:** The proposed guidance would apply to a limited-life entity when significant management activities are limited to those necessary to carry out a plan for liquidation other than that which was specified in the entity's governing documents. Indicators have been provided to help an entity determine whether a plan for liquidation differs from that which was specified in the governing documents. Do you agree with the proposed guidance about when a limited-life entity should use the liquidation basis of accounting? If not, why?

We agree that the proposed guidance should apply to a limited-life entity when significant management activities are limited to those necessary to carry out a plan for liquidation; however, we believe it should apply regardless of whether the plan for liquidation differs or is the same as that specified in its governing documents. We believe that financial statements prepared on the liquidation basis of accounting provide the users of financial statements with relevant information when the entity's liquidation is imminent and therefore don't believe that the basis of presentation should be different between two otherwise similar entities just because one initially had a limited-life and the other did not or whether the life was extended or shortened from the one originally contemplated in its governing documents. We also acknowledge that when the time period extends beyond a few years, the usefulness of the information diminishes and therefore it will be important to provide additional examples and guidance around situations clarifying when liquidation is imminent for limited-life entities so that the liquidation of basis of accounting is not adopted prematurely.

If it is determined that the current position is appropriate, we do not believe that the language in paragraph 205-30-25-3 accurately reflects the intended requirement. Paragraph 205-30-25-3 states in part, "liquidation is imminent when significant management decisions about furthering the ongoing operations of the entity have ceased or they are substantially limited to those necessary to carry out a plan for liquidation other than the plan specified at inception." With the use of "or" in the section it could be interpreted in such a way that a limited-life entity would apply the liquidation basis when significant management decisions about furthering the ongoing operations of the entity have ceased without regard to whether the plan for liquidation differs from that specified at the entity's inception. We suggest either replacing "or" with "and" or deleting the words "about furthering the ongoing operations of the entity has ceased or they" since, under the proposal, a limited-life

entity would only adopt the liquidation basis if it adopts a plan for liquidation that differs from the plan specified in its governing documents.

It has been our experience that most limited-life entities do not have a formal and complete plan of liquidation at inception even though they know they will have to liquidate no later than some specified date in the future. As a result they will adopt a more formalized plan for liquidation at some point prior to their specified termination date. Based on the current proposed guidance it is not clear if the liquidation basis of accounting would be required when the formalized plan is adopted or, since the liquidation is still going to take place on the date originally specified in the governing documents, the completion of a more detailed plan would not be considered a significant change triggering the liquidation basis of accounting. We believe additional guidance or examples related to this situation would help to ensure consistency in the application of the standard.

**Question 5:** The proposed guidance would apply to public and nonpublic entities (that is, private companies and not-for-profit organizations). Should any of the proposed amendments be different for nonpublic entities? If so, please identify those proposed amendments and describe how and why you think they should be different.

We agree with the Board's decision to make the proposed guidance applicable to both public and nonpublic entities.

## Other Recommendations

We believe that there should be additional guidance provided on the appropriate reporting of contingent liabilities that do not meet the recognition requirements under ASC 450. It is not clear if they should continue to be reported under the provisions of ASC 450 or they should be estimated and accrued with other costs in accordance with ASC 205-30-30-3. In the case of litigation contingencies it would usually be extremely difficult to determine a meaningful estimated cost during the early stages of the case or for unasserted claims.

Further, because of the unique circumstances we feel it would be helpful to provide additional guidance as it relates to when liquidation of an investment company would be considered imminent. For example when the entity has reached a point whereby they are not accepting any new capital and have suspended redemptions, is the collection of the management fee and management of the investments sufficient to be considered to be making decisions about furthering ongoing operations? In most cases a plan of liquidation was included in its initial governing documents and part of the management strategy is to optimize the investors' return by selling its underlying assets. For example, in the case of a portfolio of illiquid investments, should the time period before expected final distribution be considered?

We also are concerned about the application of the proposed guidance as it relates to the accounting for employee benefit plans. In regards to plan accounting, we recommend the following items be addressed:

• The proposed ASU requires that assets and liabilities be measured at the estimated amount of cash or other consideration that an entity expects to collect or pay to carry out its plan for liquidation. Estimated costs to dispose of assets or liabilities must also be accrued and presented in the aggregate separately from the measurement of those assets or liabilities. Other costs and income that an entity expects to incur or earn are required to be accrued through the date at which the entity expects to complete its liquidation.

The proposed requirement to accrue other costs and income separately from plan assets will be inherently difficult for employee benefit plans and of questionable benefit to financial statement users. For defined contribution plans, net assets equal the total value of the

individual participant accounts, or in other words, the amount to be distributed to the participant if redeemed at the reporting date. Recording the future income and expense separately from the value of these investments would not be of any additional benefit to the participant. Defined benefit plans may have difficulty estimating the timing of their distributions given that the final distribution of the assets could occur many years after the decision to terminate is made because of pending regulatory approval or other administrative steps to ensure an orderly disposal process. Accordingly, fair value may be a more relevant measurement of plan assets for financial statement users.

- For defined benefit plans, current guidance allows benefit obligations to be measured and reported either as of the beginning of the plan year or end of the plan year. Current guidance does not address whether a terminating plan should present the obligation as of the end of the year once liquidation basis is adopted. It is unclear whether end of year measurement would be required under the proposed ASU and whether these obligations would be recorded as a liability on the statement of net assets on liquidation or whether separate disclosure of the obligation would continue to be sufficient. We recommend FASB provide guidance on the measurement date as well as presentation and disclosures for benefit obligations.
- We recommend the FASB consider excluding defined contribution plans from the scope of this proposed ASU. Under the proposed guidance, it is unclear whether defined contribution plans would be required to report benefit obligations in the plan financial statements when applying the liquidation basis of accounting. In addition, under the proposed ASU plan assets would no longer be recorded at fair value. Under the current accounting for defined contribution plans, the assets are already recorded at fair value, with the exception of fully benefit responsive contracts with insurance companies which are shown at fair value with an adjustment to contract value. If a liability is to be recorded for benefit obligations, it would most likely be at the same value as the plan assets available for benefits. Additionally, defined contribution plans currently are not required to report benefit obligations (benefits payable) in the plan financial statements as the plan's net assets available to pay benefits equal the sum of participants' account balances. Benefits are recorded only when paid, and benefits payable are not accrued in these plans. If defined contribution plans are not excluded from the scope of this document, we request that FASB clarify whether these plans would need to record a liability for benefit obligations. In addition, if defined contribution plans remain in scope of this document, we request that FASB provide guidance on accounting and disclosure for contracts with insurance companies for a terminating defined contribution plans, as well as the applicability of fair value disclosures for these and other instruments upon adoption of liquidation basis.
- If the proposed ASU is adopted for employee benefit plans, the proposed terminology "For terminating plan assets" in sections 960-40-35-2 and 965-40-35-2 should be amended to either "For terminating plans" or "For terminating plans, assets and accumulated plan benefits/obligations", depending on FASB's intent.

We would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Rick Day (563-888-4017) or Ginger Buechler (612-455-9411).

Sincerely,

McHadrey LCP
McGladrey LLP