Purpose of today’s meeting

1. On July 2, 2012, the FASB issued a proposed Accounting Standards Update, *Presentation of Financial Statements (Topic 205): The Liquidation Basis of Accounting*. The Exposure Draft provides guidance about how and when an entity should apply the liquidation basis of accounting. The comment period ended on October 1, 2012. As of the date of this summary, the Board has received 23 responses from stakeholders.

2. The purpose of this meeting is to provide the Board with the following:
   (a) Summary of feedback from stakeholders about the Exposure Draft
   (b) Plan for redeliberations.

3. During redeliberations, the staff will more closely analyze each of the issues described in this summary. The purpose of this meeting is to provide the Board with an inventory of those topics that the staff expects to revisit at future Board meetings.

4. The remainder of this summary is organized as follows:
   (a) Comment letter demographics
   (b) Summary of comments received
   (c) Plan for redeliberations.

The staff prepares Board meeting handouts to facilitate the audience’s understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.
Comment letter demographics

5. The following table summarizes respondents’ demographics:

<table>
<thead>
<tr>
<th>Type</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Practitioners</td>
<td>11</td>
</tr>
<tr>
<td>State CPA Societies</td>
<td>5</td>
</tr>
<tr>
<td>Other*</td>
<td>7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>23</strong></td>
</tr>
</tbody>
</table>

*Includes professional organizations, a preparer, staff from a regulator, an individual, and the Private Company Financial Reporting Committee (PCFRC).

Summary of feedback

6. During the comment period, the staff met with the PCFRC to discuss the operationality of the proposed standard. Much of the feedback from the PCFRC was similar to that received through the comment letter process and that is reflected throughout this summary.

7. Respondents broadly support the objectives of the Exposure Draft. There is currently no authoritative guidance about the liquidation basis of accounting (the liquidation basis). Consequently, there is currently broad diversity in practice. Respondents noted that the introduction of authoritative guidance about this topic will help to resolve some of the diversity in practice; however, those respondents request that the Board clarify some of the guidance (particularly the measurement guidance) in the Exposure Draft.

8. The Board specifically asked five questions of stakeholders in the Exposure Draft. However, those stakeholders were invited to comment on all matters that they deemed relevant. The staff has separated respondent feedback into five categories:
(a) Recognition

(b) Measurement

(c) Presentation and Disclosure

(d) Scope

(e) Other.

**Recognition**

*Definition of imminent*

9. Most respondents agreed with the proposal to introduce a clear principle into U.S. generally accepted accounting principles (GAAP) to help the entity determine when it should report under the liquidation basis. Those respondents agreed with the use of the term *imminent*; however, some think that a determination about whether liquidation is imminent should be based on timing (that is, how soon will the entity liquidate?) while others noted that the determination should be based on certainty (that is, how certain is it that the entity will liquidate?).

10. Respondents who noted that a determination about whether liquidation is imminent should be based on timing provided suggestions for modifications, including the following:

(a) There should be a relatively short period of time between the date liquidation is considered *imminent* and when the entity is substantially liquidated.

(b) An entity should not apply liquidation basis until:

   (i) The liquidation process has begun or is ready to begin; and
(ii) Significant management decisions about furthering the ongoing operations have ceased or they are substantially limited to those necessary to carry out the plan for liquidation.

11. Respondents who noted that the determination about whether liquidation is imminent should be based on certainty provided suggestions for modifications, including the following:

(a) Liquidation should be considered imminent in an involuntary bankruptcy only after the entity’s response (to the creditor’s bankruptcy filing) and court’s final response back to the entity.

(b) The definition of *imminent* should consider the effect of regulatory or third-party approvals (for example, shareholder, bankruptcy court, Internal Revenue Service, and so forth) that the entity must obtain before it can liquidate. Some respondents noted that the Exposure Draft is unclear about whether those approvals are required to support a determination that liquidation was imminent.

12. Some respondents noted that it is unclear to them whether the focus of a decision about whether liquidation is imminent should be on:

(a) Whether a formal decision has been made to liquidate the entity;

(b) The nature of management’s ongoing activities (that is, whether they resemble those of an entity that is winding down); or

(c) Some combination of both management decisions and its ongoing activities.
**Application to limited-life entities**

13. Many respondents noted that the provision of separate recognition criteria for limited-life entities is conceptually inconsistent and the criteria would be difficult to apply. Those respondents suggested that if the differential criteria for limited-life entities are carried forward to the final standard, the Board should modify the proposed wording to better illustrate how they should be applied.

14. Many respondents suggested that the broad principle (that is, entities should report under the liquidation basis when liquidation is imminent) should be applied equally to all types of entities regardless of whether their lives are contractually limited.

(a) A few respondents noted that all limited-life entities should be required to report under the liquidation basis at some point. Those respondents suggested that the Board and staff should conduct outreach with financial statement users to determine the appropriate course.

(b) Most respondents noted that liquidation should be considered imminent for limited-life entities only when liquidation is forced or is otherwise disorderly. Those respondents suggested deleting the remaining indicators that a plan of liquidation differs from that which was specified at inception.

(i) One respondent commented:

> We generally agree that the liquidation basis of accounting should apply to limited-life entities when (1) the liquidation was not expected or (2) an entity was forced to dispose of its assets in a disorderly manner. This criterion has been incorporated into ASC 205-30-25-3(b) under the proposed ASU, which states, “The entity is forced to dispose of its assets in a manner that is not orderly or in exchange for consideration that is not commensurate with the fair value of such assets.” We believe that this indicator should be
the determining factor in whether a limited-life entity should use the liquidation basis of accounting to present its financial statements. (Deloitte and Touche, CL #10)

Measurement

15. The Exposure Draft would require an entity to measure its assets and liabilities based on the cash it expects to receive or pay in liquidation, respectively. Broadly speaking, respondents agreed with the measurement principle; however, several respondents noted that the proposed measurement is not operational or auditable as written in the Exposure Draft: Those respondents are concerned primarily about the following:

(a) The degree of subjectivity that would be involved in measuring the entity’s assets and liabilities

(b) The proposal to measure liabilities at an expected amount (presumably an amount less than the contractually stated amount) despite those liabilities being subject to formal liquidation proceedings

(c) The proposal to accrue the future income and expenses expected to be realized or incurred during liquidation.

Subjectivity of the proposed measurements

16. The Exposure Draft would require an entity to measure its assets and liabilities based on the amount of cash it expects to collect or pay in liquidation, respectively. The entity would be required to accrue expected disposal and/or liquidation costs as a separate line item in the statement of net assets in liquidation.

17. Some respondents noted that those measurement techniques, particularly as they would apply to liabilities, would be very subjective and therefore difficult to audit. One respondent commented:
The measurement basis of “expects to collect or pay” is not clear in Proposed Update 205-30-30-1, and diversity likely will result without clarification. For example, when the amount that an entity expects to collect or pay falls within a range of possible amounts, it is unclear what amount should be recognized. Using a measurement basis similar to that used in ASC 450 for loss contingencies would appear to be most appropriate. Using other estimates, for example, a probability-weighted amount would outweigh the benefits from using such an estimate. (Ernst and Young, CL #13)

18. Other respondents noted that the subjectivity of the estimates would increase with the length of the liquidation period. For that reason, several respondents suggested that the recognition threshold (that is, imminent) should be defined in a manner that emphasizes the expected timing of liquidation over the likelihood of liquidation (see paragraph 9).

**Measurement of liabilities subject to liquidation proceedings**

19. Some respondents noted that it would be inappropriate to derecognize or write down a liability before the entity has been relieved of its legal obligation to pay (that is, through formal proceedings). Several of those respondents proposed modifications to the Exposure Draft to ensure that the measurement guidance is transparent and representationally faithful:

(a) A few respondents suggested that the contractual amounts should be presented alongside the expected amount on the face of the financial statements. Those respondents noted that presentation in the notes to the financial statements would be helpful but not necessarily preferable.

(b) One respondent suggested that a roll-forward type presentation of the statement of net assets in liquidation would help alleviate concerns about the subjectivity of the measurements and provide
users with better information. This respondent suggested that the entity would present the following:

(i) Contractual amount +/-
(ii) Effect of cash payments or court decisions +/-
(iii) Management adjustments relating to preparation of liquidation basis financial statements =
(iv) Ending balance under the liquidation basis.

Accrual of income and expenses expected during liquidation

20. Many respondents noted that the proposed accrual of income and expense would be subjective and somewhat arbitrary. Respondents indicated that the accrual would be particularly troublesome because it would pertain to the following:

(a) Expected change in the market value of investments (based on market variable)
(b) Expected dividend income (based on management decision by investee)
(c) Liquidations that are expected to last for greater than one year.

21. A few respondents questioned whether the accrual of expenses would be only for incremental costs to liquidate or for all operating costs. That is, would an entity accrue only those costs that it wouldn’t have incurred had it not been liquidating or would it accrue all expected future costs? One practitioner suggested that it might be helpful for the entity to disaggregate total expenses between those two categories.

22. Many respondents took note of the inclusion in paragraph 205-30-50-1(c) of “discount rates used” as an example of an assumption that should be disclosed. Those respondents noted that the implication of the stated measurement objective being “expected” payments or collections is that
the amounts in the financial statements should not be discounted back to
the date of the statement of net assets in liquidation. Furthermore, those
respondents noted that accounting for the time value of money would seem
to contradict the overall objective of the guidance (that is, to communicate
to owners how much they should reasonably expect to recover from their
investments). Those respondents suggested that the inclusion of “discount
rates used” makes the Board’s intention unclear.

Presentation and disclosure

23. Several respondents noted that there is currently no guidance about the
presentation of financial statements under the liquidation basis.
Respondents noted that current practice is mixed and that the Exposure
Draft is unclear about the following topics:

(a) Required financial statements
(b) Preparation of comparative financial statements
(c) Required presentation during the period of adoption
(d) Extent of the required footnote disclosures.

Required financial statements

24. One respondent noted that in an informal review of recent financial
statements prepared under the liquidation basis, it observed fundamental
discrepancies in matters as simple as the type and labeling of the financial
statements prepared under the liquidation basis. This respondent noted that
it observed instances in which preparers failed to include a required
financial statement or unnecessarily included a financial statement that was
not required.
25. This respondent noted that the proposal should help to resolve some of the diversity in practice relating to the presentation of liquidation basis financial statements. However, this respondent stated that the proposed guidance should be more explicit about whether an entity should be required to prepare any or all of an income statement, balance sheet, and statement of cash flows in addition to the statements that would be explicitly required under the Exposure Draft.

*Preparation of comparative financial statements*

26. Many respondents noted that the Exposure Draft is unclear about whether an entity should prepare comparative financial statements when reporting under the liquidation basis. Those respondents generally asserted that the period after adoption of the liquidation basis is not comparable to any of the preceding periods, and this notion should be acknowledged in the final standard. A few respondents cited as a reference point paragraph 852-10-45-26, which indicates that the fresh-start financial statements of an entity that emerges from Chapter 11 bankruptcy are not comparable to any prior period financial statements because those financial statements are effectively for a new entity. Those respondents requested similar guidance in the final standard.

*Required presentation during the period of adoption*

27. Several respondents questioned how they should present their financial data when liquidation was determined to be imminent during the reported period. Many respondents interpreted that they should prepare their financial statements using a “black line” approach, meaning that in the period of adoption they would show a stub period under the going concern basis separately from the liquidation basis presentation from the date when liquidation became imminent.
28. Other respondents suggested that an entity should be permitted to adopt the liquidation basis as of the beginning of the reporting period (convenience date) instead of the date when liquidation became imminent as long as the effect of doing so is not significant. Those respondents noted that the most important information about the entity in liquidation would be its ending net assets, which would not be affected by the use of a convenience date.

**Extent of the required footnote disclosures**

29. Many respondents disagreed with the proposed guidance in paragraph 205-30-50-1, which indicates that the proposed disclosures under the Exposure Draft should be provided “in addition to all other disclosures required by U.S. GAAP.” Those respondents noted that there are many disclosures that would not be relevant to a user of financial statements prepared under the liquidation basis. A few respondents provided lists of the disclosures that they believe would be irrelevant under the liquidation basis, which included disclosures about the following:

(a) Fair value measurements
(b) Investment securities classified as available for sale
(c) Summary of significant accounting policies
(d) Operating segments
(e) Concentrations of credit risk
(f) Goodwill and other intangible assets
(g) Share-based payments.

30. Some respondents stated that the Board should consider a principle of relevance for disclosure requirements to avoid having entities prepare irrelevant and costly disclosures. Those respondents noted that they would have to maintain two sets of books (going concern and liquidation basis) if
they were required to make all required disclosures under U.S. GAAP while reporting under the liquidation basis.

31. One respondent suggested that the following disclosures should be required in liquidation basis financial statements in addition to those disclosures that would be explicitly required under the Exposure Draft:

(a) A statement that the actual values realized in liquidation may be different from the estimated values in the current financial statements

(b) Identification of whether the anticipated liquidation and the basis for valuation reflect a forced sale of assets or an orderly liquidation

(c) Ongoing disclosures about the pre-discharge amount of liabilities, the priority of each class of liabilities, and a cumulative listing of recoveries by claimants.

Scope

32. A few respondents requested scope exceptions for employee benefit plans and investment companies because for each of those entities income and expenses depend heavily on unpredictable (that is, market) variables and because liquidations of those entities often take longer than one year.¹ Those respondents noted that liquidation basis financial statements are not useful or reliable because future income/expense and asset appreciation/depreciation cannot be estimated reliably. Furthermore, those respondents noted that fair value should approximate liquidation value as long as they are afforded an extended period of time to liquidate their assets (that is, the market is orderly).

¹ In order to complete liquidation, employee benefit plans must obtain approval from the Internal Revenue Service which often takes several years. Investment companies sometimes take several years to liquidate as they wait for advantageous market developments relating to their assets held for sale.
Employee benefit plans

33. Several other respondents, while not requesting an explicit scope exception for employee benefit plans, noted that there might be a need for specialized guidance, clarifying language, or additional cross-references for those entities.

Currently, when the plan sponsor has made the decision to terminate an employee benefit plan, the plan follows the guidance in FASB ASC 960-40, 962-40, and 965-40; however, this guidance is not specific and, therefore, not particularly helpful. This proposed ASU does not aid in clarifying the reporting and disclosure issues for terminating plans and, in some ways, it causes even more confusion. We request that the Board consider the concerns outlined below and either provide more guidance to plans in this ASU or exclude employee benefit plans from the scope of the document and address these issues in a separate project specifically tailored to terminating employee benefit plans.

(The Financial Reporting Executive Committee of the American Institute of Certified Public Accountants, CL #21)

34. Those respondents suggested that the following issues would have to be addressed to make the proposal operational for employee benefit plans:

(a) Clarify the significance of required third-party approvals in determining when liquidation is imminent.

(b) Estimates of future income and expense would not be possible because those estimates would rely on market variables.

(c) Timing of benefit payments could not be estimated in any meaningful way.

(d) Fair value would seem to be a more relevant measurement for those entities because they generally dispose of their assets in an orderly fashion.
(e) Clarification and/or transition guidance relating to the acceptability of a beginning-of-year measurement of the accumulated benefit obligation (acceptable under current guidance).

(f) Guidance about how to classify participant account balances for a defined contribution plan (that is, would they become liabilities of the plan?).

Investment companies

35. In addition to their broader reasons for requesting a scope exception for investment companies (that is, because the liquidation basis is not particularly useful for those entities), some respondents interpreted the proposed guidance as currently worded to mean that investment companies would be required to measure their assets and estimate appreciation of those assets in a manner that would conflict with the Investment Company Act of 1940.

We are concerned that the Proposal’s requirement to 1) measure assets at the amount of cash expected to be collected, and 2) immediately recognize future income and expense expected to be collected/paid during the duration of the liquidation, may conflict with measurement and recognition requirements applicable to SEC registered investment companies. Accordingly, we recommend that SEC registered investment companies be excluded from the scope of the Proposal. (Investment Company Institute, CL #22)

Other substantive feedback

36. The proposed definition of liquidation indicates that liquidations brought about by mergers or acquisitions are not liquidations as they are intended to be understood under the Exposure Draft. A few respondents interpreted the definition in the Exposure Draft to include a scope-out provision for those transactions. Those respondents noted that this should be clarified
explicitly in the scope section of the final standard. A few respondents noted that the proposed definition of liquidation could cause unintended consequences as it would interact with Topic 805, Business Combinations. For example, if the definition of liquidation were read literally it might preclude some sales of assets from being identified as liquidations if they also meet the definition of business under Topic 805.

37. A few respondents noted that even though the recognition threshold is high for applying the liquidation basis, there will be instances in which the entity returns from the liquidation basis to the going concern basis. Those respondents noted the lack of guidance about how an entity should account for a return to the going concern basis. Some of those respondents suggested that the entity should apply fresh-start accounting under Topic 852, Reorganizations, and that the final standard could simply cross-reference to that guidance.

38. Respondents also made several drafting suggestions. The staff has logged those suggestions and plans to address them during the balloting process.

Plan for redeliberations

39. The staff tentatively plans on conducting the following activities during redeliberations:

(a) Outreach: The staff plans to conduct outreach as necessary with financial statement users. The primary focus of the outreach will be to determine whether stakeholders agree with the following:

(i) Proposed recognition threshold for limited-life-entities (that is, whether those entities should only be required to report under the liquidation basis if they liquidate in a manner that differs from that which was anticipated at inception)

(ii) Proposed presentation requirements (that is, would they find a roll-forward type presentation helpful?).
(b) Board meetings:

(i) December 2012 Board meeting to address the recognition and scope issues described in this summary

(ii) January 2013 Board meeting to address the measurement issues described in this summary

(iii) February 2013 Board meeting to address the presentation/disclosure and other issues described in this summary.

(c) Balloting: Assuming decisions are reached at each of the planned Board meetings, the staff plans to complete the balloting process during the first half of 2013.