

## Heads Up

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## Born Around the Fourth of July FASB Proposes Guidance on the Liquidation Basis of Accounting

by Stuart Moss and Amy Zimmerman, Deloitte & Touche LLP

### Project History

The Board added a project on going concern and the liquidation basis of accounting to its agenda in May 2007. In October 2008, the FASB issued an exposure draft on going concern for public comment. Since then, the Board has continued deliberating this topic and ultimately decided to consider going concern and the liquidation basis of accounting separately.

### Overview of Proposed ASU on Liquidation Basis

On July 2, 2012, the FASB issued a [proposed ASU](#)<sup>1</sup> that would provide guidance on when and how to apply the liquidation basis of accounting. Under the proposed ASU, an entity would be required to use the liquidation basis of accounting to present its financial statements when it determines that liquidation is imminent. According to ASC 205-30-25-2 (added by the proposed ASU), liquidation would be considered imminent in either of the following situations:

- a. 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 will be blocked by other parties (for example, those with protective rights).
- b. A plan for liquidation is imposed by other forces (for example, involuntary bankruptcy) and the likelihood is remote that the entity will return from liquidation.

Liquidation would also be considered 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” that is different from a liquidation plan specified in an entity’s governing documents. The proposed ASU provides indicators for determining whether the liquidation plan changed from what was specified in the governing documents. These indicators include, but are not limited to, the following:

- The expected liquidation date differs from the date specified in the governing documents.
- Assets are disposed of for a value other than fair value or the disposal of the assets is not orderly.
- The entity’s governing documents were amended after their initial creation.

<sup>1</sup> FASB Proposed Accounting Standards Update, *The Liquidation Basis of Accounting*.

An entity would also be required to include expanded disclosures in its financial statements for the reporting period in which the entity determines that liquidation is imminent.

**Editor’s Note:** During its deliberations, the Board proposed various definitions of the term “imminent,” including a definition that focused primarily on applying the liquidation basis of accounting when an entity’s decision makers approved a liquidation plan. However, the Board acknowledged that in accordance with this definition, a limited-life entity may have had to apply the liquidation basis of accounting at the entity’s inception. Because this was not the Board’s intent, the FASB revised the definition to limit the application of the liquidation basis of accounting to situations in which the liquidation was unplanned (i.e., the liquidation plan differed from the liquidation plan in the governing documents).

If liquidation is determined to be imminent during a reporting period, an entity would apply the proposed guidance prospectively from the date on which it makes this determination, “with a cumulative-effect adjustment to the statement of changes in net assets in liquidation, as applicable.” As clarified in the proposed ASU’s examples and implementation guidance, if a normal operating entity’s board of directors, who have the authority to put a liquidation plan into effect, approved a plan for liquidation on September 16, 20X2, the entity would use the liquidation basis of accounting to prepare its financial statements as of that date.

An entity’s financial statements should contain relevant information about the entity’s resources and obligations upon liquidation. When applying the liquidation basis of accounting, the entity would need to initially measure and present the values of its assets and liabilities to reflect the amount the entity expects to receive or to pay in cash or other consideration. The entity would present — separately from the measurement of the assets and liabilities — the expected aggregate liquidation and disposal costs to be incurred during the liquidation process. In addition, the entity would estimate and accrue the expected future costs and income to be incurred or realized during the course of liquidation, such as payroll expense and interest income. These estimates would be remeasured as of each subsequent reporting period.

**Editor’s Note:** Paragraph BC9 of the proposed ASU notes that the “assets and liabilities would be measured at the estimated amount of cash expected to be collected or paid. . . . [This amount] . . . differs from fair value because it does not assume that the related dispositions would be conducted in an orderly manner.” Therefore, an entity that records assets at fair value would need to identify and record differences between the fair value recorded and the expected recoverable cash.

Comments on the proposed ASU are due by October 1, 2012. The proposal would affect all entities.

## Presentation and Disclosures

At a minimum, the proposed ASU would require entities to present a statement of net assets in liquidation and a statement of changes in net assets in liquidation. An entity would also be required to include expanded disclosures in its financial statements for the reporting period in which the entity determines that liquidation is imminent.

ASC 205-30-50-1 (added by the proposed ASU) states that an entity would have to disclose all of the following:

- a. That the financial statements are prepared using the liquidation basis of accounting, including the facts and circumstances surrounding the adoption of the liquidation basis of accounting.
- b. A description of the entity’s plan of liquidation, including, at a minimum, a description of the manner by which the entity expects to dispose of its assets and liabilities and the expected duration of the liquidation.
- c. The methods and significant assumptions used to measure the assets and liabilities, including subsequent changes to those methods and assumptions. Significant methods and assumptions might include, for example, the nature and source of expected future cash flows and discount rates used.
- d. The type and amount of costs and income accrued in the statement of changes in net assets in liquidation.

## Effective Date

The Board will decide on an effective date after further deliberation. The guidance would be adopted as of the beginning of an entity's first annual reporting period that begins after the effective date and applied prospectively to its interim or annual reporting period after the effective date. Early application would be permitted.

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