Liquidation Basis of Accounting

Public companies, private companies, not-for-profit organizations, and employee benefit plans may soon have more guidance about how to adapt their financial reporting when they cross the line from going concerns to entities facing liquidation. Liquidation means the entity plans to convert its assets to cash, settle its obligations, and distribute any remaining cash or assets to its owners. The reasons for liquidation range from voluntary determinations, such as a decision that a company's business model can no longer be sustained, to compulsory causes, such as an action by creditors or a court-ordered liquidation. Whatever the cause, when a company reaches this point, it means that general-purpose financial statements no longer provide the kinds of information most useful to creditors.

To promote consistent reporting in these unusual times, the FASB has issued a Proposed Accounting Standards Update (ASU) with guidance on how and when entities should apply a different basis known as the liquidation basis of accounting. This article highlights the proposed guidance and open questions.

Highlights of Proposed Changes

Currently, there is minimal guidance on the liquidation basis of accounting. The proposed ASU would provide the following guidelines and principles.

1. **Terms and conditions.** To reduce diversity in practice, the proposed ASU would establish uniform conditions that would trigger a requirement to use the liquidation basis of accounting. Specifically:

   - A company or other entity would use the liquidation basis of accounting for its financial statements when it determines that liquidation is imminent. Generally, this would mean that: (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, or (b) a plan for liquidation is imposed by other forces, and the likelihood is remote that the entity will return from liquidation.

   - In this context, the term "liquidation" would include liquidations caused by both voluntary and compulsory causes. It would not include a dissolution via a merger or acquisition.

2. **Guidance for limited-life entities.** Special guidelines would apply to entities if their governing documents at inception provide a specific plan for liquidation. Included in this category are entities commonly known as "limited-life" entities. For these entities, liquidation would 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 differs from the plan specified in the governing documents. The proposed ASU provides a list of factors that indicate the plan has changed from the one specified in the original

governing documents. Examples include the use of a different expected liquidation date or disposals of assets in a manner other than the one specified in the original governing documents.

3. **Assets and liabilities.** The liquidation basis of accounting would be applied by measuring assets and liabilities at the estimated amount of cash or other consideration that the entity expects to collect or expects to pay to settle its obligations. An entity using this basis of accounting would also need to accrue the expected future costs and income to be incurred or realized during the course of liquidation, such as payroll expense and interest income.

4. **Financial statements.** The required financial statements for a company using the liquidation basis of accounting would include: (a) a statement of net assets in liquidation, and (b) a statement of changes in net assets in liquidation. These types of financial statements are appropriate for entities facing liquidation because they shift the emphasis from reporting about an entity's economic performance and position to reporting about the amount of cash that would be available to investors after liquidation. Companies using the liquidation basis of accounting would be required to make certain disclosures, including the following:

    - A statement that the financial statements are prepared using the liquidation basis of accounting, including the facts and circumstances surrounding the adoption of this basis.
    - A description of the entity's plan for liquidation, including a discussion of how the entity expects to dispose of its assets and how long the liquidation is expected to take.
    - A description of the methods and significant assumptions underlying the measures of assets and liabilities and any changes in those methods and assumptions.
    - A breakdown of the type and amount of costs and income accrued in the statement of changes in net assets in liquidation.

5. **Transition and effective date.** The proposed changes would be effective as of the beginning of the annual period of adoption and applied prospectively from the day the liquidation becomes imminent. The effective date will be considered following the end of the comment period. If adopted as proposed, early adoption would be permitted.

Open Questions

The comment period was open until October 1, 2012, and the FASB specifically requested comments on a number of open questions, including whether the guidance on how to prepare the financial statements is sufficient and operational, whether the guidance should differ for entities such as investment companies whose primary measurement attribute is fair value, whether the guidance for limited-life entities is appropriate, and whether the same guidance should apply to both public and nonpublic entities (meaning private companies and not-for-profit entities) or, if not, how the guidance should differ for private companies and not-for-profit entities. The FASB Board met on November 6, 2012 to review comment letters received, and on December 12, 2012 to begin redeliberations. The FASB Board plans to complete redeliberations on the proposed ASU in January 2013.

For More Information

If you have questions or comments regarding this proposed ASU, please contact your CBIZ Tofias & Mayer Hoffman McCann advisor, or you may reach us at TheBottomLine@cbiztofias.com and 888.761.8835.