

# FINANCIAL ACCOUNTING SERIES

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## ACCOUNTING STANDARDS UPDATE

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No. 2013-07  
April 2013

### Presentation of Financial Statements (Topic 205)

### Liquidation Basis of Accounting

An Amendment of the *FASB Accounting Standards Codification*®

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Financial Accounting Standards Board  
of the Financial Accounting Foundation

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401 MERRITT 7, PO BOX 5116, NORWALK, CONNECTICUT 06856-5116



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Liquidation Basis of Accounting

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# Summary

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## Why Is the FASB Issuing This Accounting Standards Update (Update)?

There is minimal guidance in current U.S. generally accepted accounting principles (GAAP) that addresses when it is appropriate to apply, or how to apply, the liquidation basis of accounting. Consequently, there is diversity in practice. The amendments in this Update are being issued to clarify when an entity should apply the liquidation basis of accounting. In addition, the guidance provides principles for the recognition and measurement of assets and liabilities and requirements for financial statements prepared using the liquidation basis of accounting.

## Who Is Affected by the Amendments in This Update?

The amendments apply to all entities that issue financial statements that are presented in conformity with U.S. GAAP except investment companies that are regulated under the Investment Company Act of 1940 (the 1940 Act).

## What Are the Main Provisions?

The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (a) a plan for liquidation is 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 being imposed by other forces (for example, involuntary bankruptcy). If a plan for liquidation was specified in the entity's governing documents from the entity's inception (for example, limited-life entities), the entity should apply the liquidation basis of accounting only if the approved plan for liquidation differs from the plan for liquidation that was specified at the entity's inception.

The amendments require financial statements prepared using the liquidation basis of accounting to present relevant information about an entity's expected resources in liquidation by measuring and presenting assets at the amount of the expected cash proceeds from liquidation. The entity should include in its presentation of assets any items it had not previously recognized under U.S. GAAP but that it expects to either sell in liquidation or use in settling liabilities (for example, trademarks).

An entity should recognize and measure its liabilities in accordance with U.S. GAAP that otherwise applies to those liabilities. The entity should not anticipate that it will be legally released from being the primary obligor under those liabilities, either judicially or by creditor(s). The entity also is required to accrue and separately present the costs that it expects to incur and the income that it expects to earn during the expected duration of the liquidation, including any costs associated with sale or settlement of those assets and liabilities.

Additionally, the amendments require disclosures about an entity's plan for 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 process.

## How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

U.S. GAAP provides minimal guidance on the application of the liquidation basis of accounting. The new guidance will improve the consistency of financial reporting for liquidating entities.

## When Will the Amendments Be Effective?

The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

Entities that use the liquidation basis of accounting as of the effective date in accordance with other Topics (for example, terminating employee benefit plans) are not required to apply the amendments. Instead, those entities should continue to apply the guidance in those other Topics until they have completed liquidation.

## How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS states that an entity should prepare financial statements on the going concern basis of accounting "unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so" (paragraph 25 of IAS 1, *Presentation of Financial Statements*). IFRS currently does not provide explicit guidance on when or how to apply the liquidation basis of accounting.



# Amendments to the *FASB Accounting Standards Codification*<sup>®</sup>

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## Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–20. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~. **[For ease of readability, the newly added Subtopic is not underlined.]**

## Amendments to Master Glossary

2. Add the following new Master Glossary terms, with a link to transition paragraph 205-30-65-1, as follows:

### **Liquidation**

The process by which an entity converts its assets to cash or other assets and settles its obligations with creditors in anticipation of the entity ceasing all activities. Upon cessation of the entity's activities, any remaining cash or other assets are distributed to the entity's investors or other claimants (albeit sometimes indirectly). Liquidation may be compulsory or voluntary. Dissolution of an entity as a result of that entity being acquired by another entity or merged into another entity in its entirety and with the expectation of continuing its business does not qualify as liquidation.

### **Statement of Changes in Net Assets in Liquidation**

A statement that presents the changes during the period in net assets available for distribution to investors and other claimants during liquidation.

### **Statement of Net Assets in Liquidation**

A statement that presents a liquidating entity's net assets available for distribution to investors and other claimants as of the end of the reporting period.

## Addition of Subtopic 205-30

3. Add Subtopic 205-30, with a link to transition paragraph 205-30-65-1, as follows:

# **Presentation of Financial Statements—Liquidation Basis of Accounting**

## **Overview and Background**

**205-30-05-1** The Liquidation Basis of Accounting Subtopic provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made.

## **Scope and Scope Exceptions**

**205-30-15-1** The guidance in this Subtopic applies to all entities except for investment companies regulated under the Investment Company Act of 1940. Other entities shall not apply this scope exception by analogy.

## **Glossary**

### **Fair Value**

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

### **Liquidation**

The process by which an entity converts its assets to cash or other assets and settles its obligations with creditors in anticipation of the entity ceasing all activities. Upon cessation of the entity's activities, any remaining cash or other assets are distributed to the entity's investors or other claimants (albeit sometimes indirectly). Liquidation may be compulsory or voluntary. Dissolution of an entity as a result of that entity being acquired by another entity or merged into another entity in its entirety and with the expectation of continuing its business does not qualify as liquidation.

### **Statement of Changes in Net Assets in Liquidation**

A statement that presents the changes during the period in net assets available for distribution to investors and other claimants during liquidation.

### **Statement of Net Assets in Liquidation**

A statement that presents a liquidating entity's net assets available for distribution to investors and other claimants as of the end of the reporting period.

## Recognition

**205-30-25-1** An entity shall prepare financial statements in accordance with the requirements of this Subtopic when **liquidation** is imminent unless the liquidation follows a plan for liquidation that was specified in the entity's governing documents at the entity's inception.

**205-30-25-2** Liquidation is imminent when either of the following occurs:

- 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 any of the following will occur:
  1. Execution of the plan will be blocked by other parties (for example, those with shareholder rights)
  2. The entity will return from liquidation.
- 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.

**205-30-25-3** An entity shall presume that its plan of liquidation does not follow a plan that was specified in the entity's governing documents at its inception if the entity is forced to dispose of its assets in exchange for consideration that is not commensurate with the **fair value** of those assets. Other aspects of the entity's plan of liquidation also might differ from a plan that was specified in the entity's governing documents at its inception (for example, the date at which liquidation shall commence). However, those factors should be considered in determining whether to apply the liquidation basis of accounting only to the extent that they affect whether the entity expects to receive consideration in exchange for its assets that is not commensurate with fair value.

**205-30-25-4** When using the liquidation basis of accounting, an entity shall recognize other items that it previously had not recognized (for example, trademarks) but that it expects to either sell in liquidation or use to settle liabilities. Those items may be recognized in the aggregate.

**205-30-25-5** An entity shall recognize liabilities in accordance with the recognition provisions of other Topics that otherwise would apply to those liabilities, including paragraph 405-20-40-1.

**205-30-25-6** An entity shall accrue estimated costs to dispose of assets or other items that it expects to sell in liquidation and present those costs in the aggregate separately from those assets or items.

**205-30-25-7** An entity shall accrue costs and income that it expects to incur or earn (for example, payroll costs or income from preexisting orders that the entity expects to fulfill during liquidation) through the end of its liquidation if and when it has a reasonable basis for estimation.

## Initial Measurement

**205-30-30-1** An entity shall measure assets to reflect the estimated amount of cash or other consideration that it expects to collect in settling or disposing of those assets in carrying out its plan for **liquidation**. In some cases, **fair value** may approximate the amount that an entity expects to collect. However, an entity shall not presume this to be true for all assets.

**205-30-30-2** An entity shall measure liabilities in accordance with the measurement provisions of other Topics that otherwise would apply to those liabilities (excluding the accrual of estimated disposal costs as described in paragraph 205-30-25-6 and expected income and expenses as described in paragraph 205-30-25-7). In applying those other Topics, an entity shall adjust its liabilities to reflect changes in assumptions that are a result of the entity's decision to liquidate (for example, timing of payments). However, an entity shall not anticipate being legally released from being the primary obligor under a liability, either judicially or by the creditor.

**205-30-30-3** An entity shall not apply discounting provisions in measuring the accruals for estimated disposal costs in accordance with paragraph 205-30-25-6 and expected income and expenses in accordance with paragraph 205-30-25-7.

## Subsequent Measurement

**205-30-35-1** At each reporting date, an entity shall remeasure its assets and other items it expects to sell that it had not previously recognized (for example, trademarks), liabilities (if required under the relevant Topic for those liabilities), and the accruals of disposal or other costs or income to reflect the actual or estimated change in carrying value since the previous reporting date in accordance with paragraphs 205-30-30-1 through 30-3.

## Other Presentation Matters

**205-30-45-1** At a minimum, an entity that applies the liquidation basis of accounting shall prepare the following:

- a. A **statement of net assets in liquidation**
- b. A **statement of changes in net assets in liquidation**.

**205-30-45-2** The liquidation basis of accounting shall be applied prospectively from the day that liquidation becomes imminent. The initial statement of changes in net assets in liquidation shall present only changes in net assets that occurred during the period since liquidation became imminent.

## Disclosure

**205-30-50-1** An entity shall make all disclosures required by other Topics that are relevant to understanding the entity's **statement of net assets in liquidation** and **statement of changes in net assets in liquidation**. The disclosures shall convey information about the amount of cash or other consideration that an entity expects to collect and the amount that the entity is obligated or expects to be obligated (in the case of the accruals described in paragraphs 205-30-25-6 through 25-7) to pay during the course of **liquidation**.

**205-30-50-2** At a minimum, an entity shall disclose all of the following when it prepares financial statements using the liquidation basis of accounting:

- 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 and the entity's determination that liquidation is imminent.
- b. A description of the entity's plan for liquidation, including a description of each of the following:
  1. The manner by which it expects to dispose of its assets and other items it expects to sell that it had not previously recognized as assets (for example, trademarks)
  2. The manner by which it expects to settle its liabilities
  3. The expected date by which the entity expects to complete its liquidation.
- c. The methods and significant assumptions used to measure assets and liabilities, including any subsequent changes to those methods and assumptions.
- d. The type and amount of costs and income accrued in the statement of net assets in liquidation and the period over which those costs are expected to be paid or income earned.

## Implementation Guidance and Illustrations

### > Illustrations

**205-30-55-1** The following Examples illustrate how an entity would determine when it should apply the liquidation basis of accounting. The Examples are not intended to capture every scenario under which an entity might have to apply the liquidation basis of accounting.

#### > > Example 1: Unplanned Liquidation

**205-30-55-2** Entity A is a manufacturer of goods. In 20X3, Entity A began experiencing financial difficulty because of declining market demand for its goods. On September 19, 20X3, Entity A's board of directors approved a plan for

**liquidation.** The board of directors had the authority to make the plan effective. There were no other parties that could block the execution of the plan, and the likelihood that the entity would return from liquidation was remote. Entity A should begin applying the liquidation basis of accounting as of September 19, 20X3, which is the date that Entity A's board of directors approved the plan for liquidation.

**> > Example 2: Liquidation That Does Not Follow a Plan Specified at an Entity's Inception**

**205-30-55-3** The governing documents from Entity B's inception specified that its contractual life would end in Year 10. On March 11 of Year 6, Entity B's board of directors determined that the entity would not be able to meet its debt obligations and voted to begin liquidating the entity earlier than planned. Entity B required approval from Entity C, a third party, to make its plan of liquidation effective. Entity B obtained approval from Entity C on April 10 of Year 6. No other parties could block the execution of the plan of liquidation, and the likelihood that Entity B would return from liquidation was remote. Under the plan of liquidation, Entity B anticipated that it would not have sufficient time to sell its assets in exchange for consideration that would approximate the **fair value** of those assets. Entity B should begin preparing its financial statements using the liquidation basis of accounting as of April 10 of Year 6, which is the date that the entity had obtained all of the approvals required to make its plan of liquidation effective.

## **Transition and Open Effective Date Information**

**> Transition Related to Accounting Standards Update No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting***

**205-30-65-1** The following represents the transition and effective date information related to Accounting Standards Update No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*:

- a. The pending content that links to this paragraph shall be effective for an entity that determines liquidation is imminent during annual reporting periods beginning after December 15, 2013 (effective date) and interim reporting periods therein. Early adoption of the pending content that links to this paragraph is permitted.
- b. An entity reporting on the liquidation basis of accounting as of the effective date need not apply the pending content that links to this paragraph if the entity had been applying guidance from another Topic about when and how to apply the liquidation basis of accounting (for example, terminating employee benefit plans). Otherwise, an entity reporting on the liquidation basis of accounting as of the effective date

shall record a cumulative-effect adjustment as of the date of adoption to account for any differences between the following:

1. The entity's recognized assets and the measurements of its assets and liabilities (including measurement changes resulting from changes in assumptions) under other Topics
2. The entity's recognized assets and other items (for example, previously unrecognized trademarks) and the measurements of its assets, other items, and liabilities (including measurement changes resulting from changes in assumptions) in accordance with Subtopic 205-30.

## Amendments to Subtopic 205-10

4. Amend paragraph 205-10-05-1 and add paragraph 205-10-05-4, with a link to transition paragraph 205-30-65-1, as follows:

### **Presentation of Financial Statements—Overall**

#### **Overview and Background**

**205-10-05-1** The Presentation of Financial Statements Topic includes the following Subtopics:

- a. Overall
- b. Discontinued Operations.
- c. Liquidation Basis of Accounting.

**205-10-05-4** The Liquidation Basis of Accounting Subtopic provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made.

## Amendments to Subtopic 852-10

5. Amend paragraph 852-10-60-1, with a link to transition paragraph 205-30-65-1, as follows:

### **Reorganizations—Overall**

#### **Relationships**

##### **> Financial Services—Depository and Lending**

**852-10-60-1** For the required financial statement reporting of a **liquidating bank**, see Subtopic 205-30 Section 942-810-45.

## Amendments to Subtopic 942-810

6. Amend paragraph 942-810-05-1, with a link to transition paragraph 205-30-65-1, as follows:

### **Financial Services—Depository and Lending—Consolidation**

#### **Overview and Background**

**942-810-05-1** This Subtopic provides presentation and disclosure guidance concerning ~~liquidating banks~~ and trust-preferred securities.

7. Supersede paragraph 942-810-45-2 and its related heading, with a link to transition paragraph 205-30-65-1, as follows:

#### **Other Presentation Matters**

##### **>Liquidating Bank**

**942-810-45-2** Paragraph superseded by Accounting Standards Update 2013-07. ~~A liquidating bank shall report assets and liabilities at fair values at the date of the financial statements and shall recognize in the results of each current period subsequent decreases and increases in those values. In the absence of a change in facts and circumstances as to the anticipated timing and manner of disposition, the method used to develop the initial fair values shall continue to be used for subsequent valuations. Fair values provide users of financial statements with the most relevant information for a liquidating entity.~~

## Amendments to Subtopic 960-40

8. Amend paragraphs 960-40-25-1 through 25-2, with a link to transition paragraph 205-30-65-1, as follows:



## Plan Accounting—Defined Benefit Pension Plans— Terminating Plans

### Recognition

**960-40-25-1** ~~If the decision to terminate~~ **liquidation** of a plan ~~is made~~ is deemed to be imminent (as defined in paragraph 205-30-25-2) before the end of the plan year, the plan's year-end financial statements shall be prepared ~~on~~ using the liquidation basis of accounting, ~~as described in paragraphs 962-40-35-1 through 35-2~~ in accordance with Subtopic 205-30.

**960-40-25-2** Plan financial statements for periods ending after the ~~termination decision~~ determination that liquidation is imminent are prepared ~~on~~ using the liquidation basis of accounting.

9. Supersede paragraph 960-40-35-1 and amend paragraph 960-40-35-2, with a link to transition paragraph 205-30-65-1, as follows:

### Subsequent Measurement

**960-40-35-1** Paragraph superseded by Accounting Standards Update 2013-07. ~~For terminating plan assets, changing to the liquidation basis will usually cause little or no change in values, most of which are fair values. Assets that may not be carried at fair values include all of the following:~~

- ~~a. Operating assets~~
- ~~b. Insurance and certain investment contracts carried at contract values~~
- ~~c. Subparagraph superseded by Accounting Standards Update No. 2012-04.~~

**960-40-35-2** For terminating plan assets, accumulated ~~Accumulated~~ plan benefits shall be determined ~~on a~~ using the liquidation basis of accounting (see Subtopic 205-30), and their value may differ from the actuarial present value of accumulated plan benefits reported for an ongoing plan. In general, upon termination all benefits should be reported as vested.

### Amendments to Subtopic 962-40

10. Amend paragraphs 962-40-25-1 through 25-2, with a link to transition paragraph 205-30-65-1, as follows:

## **Plan Accounting—Defined Contribution Pension Plans— Terminating Plans**

### **Recognition**

**962-40-25-1** ~~If the decision to terminate~~ liquidation of a plan ~~is made~~ is deemed to be imminent (as defined in paragraph 205-30-25-2) before the end of the plan year, the plan's year-end financial statements shall be prepared ~~on~~ using the liquidation basis of accounting, ~~as described in paragraph 962-40-35-1 in accordance with Subtopic 205-30.~~

**962-40-25-2** Plan financial statements for periods ending after the ~~termination decision~~ determination that liquidation is imminent are prepared ~~on~~ using the liquidation basis of accounting.

11. Supersede paragraph 962-40-35-1, with a link to transition paragraph 205-30-65-1, as follows:

### **Subsequent Measurement**

**962-40-35-1** Paragraph superseded by Accounting Standards Update 2013-07. ~~For terminating plan assets, changing to the liquidation basis will usually cause little or no change in values, most of which are fair values. Assets that may not be carried at fair values include all of the following:~~

- ~~a. Operating assets~~
- ~~b. Insurance and certain investment contracts carried at contract values~~
- ~~c. Subparagraph superseded by Accounting Standards Update No. 2012-04.~~

### **Amendments to Subtopic 965-40**

12. Amend paragraphs 965-40-25-1 through 25-2, with a link to transition paragraph 205-30-65-1, as follows:

## **Plan Accounting—Health and Welfare Benefit Plans— Terminating Plans**

### **Recognition**

**965-40-25-1** ~~If the decision to terminate~~ liquidation of a plan is made is deemed to be imminent (as defined in paragraph 205-30-25-2) before the end of the plan year, the plan's year-end financial statements shall be prepared ~~on~~ using the liquidation basis of accounting, ~~as described in paragraphs 965-40-35-1 through 35-2 in accordance with Subtopic 205-30.~~

**965-40-25-2** Plan financial statements for periods ending after the ~~termination decision~~ determination that liquidation is imminent are prepared ~~on~~ using the liquidation basis of accounting.

13. Supersede paragraph 965-40-35-1 and amend paragraph 965-40-35-2, with a link to transition paragraph 205-30-65-1, as follows:

## Subsequent Measurement

**965-40-35-1** Paragraph superseded by Accounting Standards Update 2013-07. ~~For terminating plan assets, changing to the liquidation basis will usually cause little or no change in values, most of which are fair values. Assets that may not be carried at fair values include all of the following:~~

- ~~a. Operating assets~~
- ~~b. Insurance and certain investment contracts carried at contract values~~
- ~~c. Subparagraph superseded by Accounting Standards Update No. 2012-04.~~

**965-40-35-2** ~~For terminating plans, benefit~~ Benefit obligations shall be determined ~~on a~~ using the liquidation basis of accounting (see Subtopic 205-30), and their carrying value may differ from the actuarial present value of benefit obligations reported for an ongoing plan. Consideration shall be given upon ~~termination~~ the determination that liquidation is imminent to whether any or all benefits become vested.

14. Add paragraph 205-30-00-1 as follows:

**205-30-00-1** The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
Fair Value	Added	2013-07	04/22/2013
Liquidation	Added	2013-07	04/22/2013
Statement of Changes in Net Assets in Liquidation	Added	2013-07	04/22/2013

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
Statement of Net Assets in Liquidation	Added	2013-07	04/22/2013
205-30-05-1	Added	2013-07	04/22/2013
205-30-15-1	Added	2013-07	04/22/2013
205-30-25-1 through 25-7	Added	2013-07	04/22/2013
205-30-30-1 through 30-3	Added	2013-07	04/22/2013
205-30-35-1	Added	2013-07	04/22/2013
205-30-45-1	Added	2013-07	04/22/2013
205-30-45-2	Added	2013-07	04/22/2013
205-30-50-1	Added	2013-07	04/22/2013
205-30-50-2	Added	2013-07	04/22/2013
205-30-55-1 through 55-3	Added	2013-07	04/22/2013
205-30-65-1	Added	2013-07	04/22/2013

15. Amend paragraph 205-10-00-1, by adding the following items to the table, as follows:

**205-10-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
205-10-05-1	Amended	2013-07	04/22/2013
205-10-05-4	Added	2013-07	04/22/2013

16. Amend paragraph 852-10-00-1, by adding the following item to the table, as follows:

**852-10-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
852-10-60-1	Amended	2013-07	04/22/2013

17. Add paragraph 942-810-00-1 as follows:

**942-810-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
Liquidating Bank	Superseded	2013-07	04/22/2013
942-810-05-1	Amended	2013-07	04/22/2013
942-810-45-2	Superseded	2013-07	04/22/2013

18. Amend paragraph 960-40-00-1, by adding the following items to the table, as follows:

**960-40-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
Liquidation	Added	2013-07	04/22/2013
960-40-25-1	Amended	2013-07	04/22/2013
960-40-25-2	Amended	2013-07	04/22/2013
960-40-35-1	Superseded	2013-07	04/22/2013
960-40-35-2	Amended	2013-07	04/22/2013

19. Amend paragraph 962-40-00-1, by adding the following items to the table, as follows:

**962-40-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
Liquidation	Added	2013-07	04/22/2013
962-40-25-1	Amended	2013-07	04/22/2013
962-40-25-2	Amended	2013-07	04/22/2013
962-40-35-1	Superseded	2013-07	04/22/2013

20. Amend paragraph 965-40-00-1, by adding the following items to the table, as follows:

**965-40-00-1** The following table identifies the changes made to this Subtopic.

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
Liquidation	Added	2013-07	04/22/2013
965-40-25-1	Amended	2013-07	04/22/2013
965-40-25-2	Amended	2013-07	04/22/2013
965-40-35-1	Superseded	2013-07	04/22/2013
965-40-35-2	Amended	2013-07	04/22/2013

*The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:*

Leslie F. Seidman, *Chairman*  
Daryl E. Buck  
Russell G. Golden  
Thomas J. Linsmeier  
R. Harold Schroeder  
Marc A. Siegel  
Lawrence W. Smith

# Background Information and Basis for Conclusions

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## Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

## Background Information

BC2. The Board originally undertook this 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. AU 341 provides guidance that requires an entity's auditors to assess whether there is substantial doubt about the entity's ability to continue as a going concern.

BC3. In October 2008, the Board issued an Exposure Draft, *Going Concern* (2008 Exposure Draft), covering the items set out in paragraph BC2. The Board received 29 comment letters in response to the 2008 Exposure Draft and considered respondents' comments during its redeliberations of the project. The Board decided that several matters warranted further deliberations. Those matters included consideration about whether to introduce guidance into U.S. GAAP about the liquidation basis of accounting. The Board chose to address that topic as part of a separate project.

BC4. In July 2012, the FASB issued an Exposure Draft of proposed Accounting Standards Update, *Presentation of Financial Statements (Topic 205): The Liquidation Basis of Accounting* (2012 Exposure Draft), which proposed guidance for liquidating entities on when and how to apply the liquidation basis of accounting. The 90-day comment period for the Exposure Draft ended on October 1, 2012, and the Board received 22 comment letters. Most respondents supported introducing into U.S. GAAP guidance on the liquidation basis of accounting. Some respondents requested that the Board consider clarifying how the guidance would apply to particular fact patterns. The Board addressed those concerns in redeliberations as explained in the following sections.

## Reasons for the Changes

BC5. The liquidation basis of accounting was not addressed in the 2008 Exposure Draft. However, several respondents indicated that there was a need for guidance about when and how to prepare financial statements using the liquidation basis of accounting. Separately, in discussions with a private company resource group, the group members indicated that guidance on the liquidation basis of accounting would be helpful to private company preparers and users of financial statements. Research performed during development of this Update indicated that there is diversity in practice in the application of the liquidation basis of accounting. Recognizing this diversity in practice, the Board decided to provide guidance on when and how to prepare financial statements using the liquidation basis of accounting.

## Scope and Scope Exceptions

BC6. The 2012 Exposure Draft proposed including all entities that apply U.S. GAAP within the scope of the Update. In redeliberations, the Board decided to exempt investment companies that are regulated under the 1940 Act from the scope of the Update because those entities would be legally restricted under the 1940 Act from remeasuring their assets and/or modifying the calculation of net asset value in any way. The Board considered removing from the scope all investment companies to preserve consistency among similar entities. However, the Board rejected this alternative because it decided that the accruals of income and expenses are important to help investors in estimating how much cash or other assets an investor might reasonably expect to recover from its investment. The amendments in this Update fill a void in existing U.S. GAAP, and the Board sought to make the guidance applicable to a broad population of entities (recognizing that investment companies regulated under the 1940 Act would be legally prohibited from applying the guidance).

BC7. Several respondents to the 2012 Exposure Draft expressed concern about the effect of the guidance on the accounting for employee benefit plans. Those respondents noted that the guidance in paragraph 205-30-25-7 could be interpreted to require that participant account balances and other plan assets be recognized as liabilities because those assets would be distributed in liquidation. Those respondents were concerned that the costs of applying the liquidation basis of accounting would outweigh the benefits. The Board considered exempting those entities from the scope of the Update. However, the Board ultimately chose not to on the basis that the concerns of those respondents were mitigated by its decision that liabilities should continue to be measured under other applicable U.S. GAAP. The Board decided not to provide implementation guidance for those entities because it does not intend for the amendments in the Update to result in a change in practice.



## Nonpublic Entities

BC8. The Board considered whether to specify different guidance for nonpublic entities. The Board obtained input from nonpublic entity stakeholders through comment letters, meetings of various advisory committees, and other meetings. Question 5 in the 2012 Exposure Draft asked respondents whether the proposed guidance should be different for nonpublic entities. Most respondents to the 2012 Exposure Draft explicitly stated that the Board should not provide different guidance for nonpublic entities. The remaining respondents did not respond to the question. Nonpublic entity stakeholders provided similar feedback in other meetings with Board members. Ultimately, the Board decided that the requirements should apply equally to public and nonpublic entities on the basis that the resulting information is no less relevant to users of the financial statements of liquidating nonpublic entities than those of liquidating public entities.

## Recognition

BC9. The Board decided that unless liquidation is imminent, an entity should be required to prepare financial statements under the assumption that the entity will continue to operate as a going concern. If liquidation is imminent, the entity's financial statements should be prepared in accordance with the amendments in this Update. The Board chose to use the term *imminent* because it is consistent with the guidance on the liquidation basis of accounting that currently exists in the AICPA's Codification of Statements on Auditing Standards Section AU 9508, *Reports on Audited Financial Statements: Auditing Interpretations of Section 508*, and Statement of Position 93-3, *Rescission of Accounting Principles Board Statements*.

BC10. In the 2012 Exposure Draft, the Board defined the term *imminent* differently for entities with contractually limited lives than for all other entities. During initial deliberations of the project, the Board decided that liquidation would be considered imminent when a plan of liquidation had been approved for any entity by those with the power to make the plan effective. The Board later noted that definition could be viewed as problematic for entities with contractually limited lives because it could have been interpreted to mean that a limited-life entity should apply the liquidation basis of accounting from its inception. The Board indicated that this was an undesirable outcome because the costs of applying the liquidation basis of accounting would outweigh the benefits in most of those instances. The Board reasoned that investors in those entities understand at inception that those entities would liquidate in a specified manner and those investors often interact freely with management. Consequently, the Board proposed in the 2012 Exposure Draft that entities with contractually limited lives should consider liquidation to be imminent only when management's

activities were substantially limited to those activities necessary to carry out the entity's plan of liquidation.

BC11. Many respondents to the 2012 Exposure Draft noted that the definition of imminent was subjective and, therefore, the guidance would be difficult to apply. The Board understood those concerns and consequently decided to revise its decision so that all entities (that is, regardless of whether those entities have contractually limited lives) should consider liquidation to be imminent only when a plan of liquidation had been approved for the entity by those with the power to make the plan effective and the likelihood is remote that the plan will be blocked by other parties or that the entity will return from liquidation. The Board specified that an entity should apply the liquidation basis of accounting only if the liquidation is unplanned (that is, if the approved plan differs from a plan of liquidation that was specified in the entity's governing documents at inception). Consequently, an entity with a contractually limited life should not apply the liquidation basis of accounting unless the approved plan of liquidation differs from the plan that was specified at inception in the entity's governing documents. In determining whether the approved plan differs from the plan specified at inception in the entity's governing documents, the Board observes that the entity should consider all relevant facts and circumstances. However, the Board expects that the entity's primary evaluation should be whether the entity is compelled to sell its assets in exchange for proceeds (that is, either in the form of cash or other consideration) that are not commensurate with the fair value of those assets.

BC12. The Board also recognizes that an entity may have items that it plans to sell in liquidation that the entity may not have previously recognized under U.S. GAAP, such as trademarks or patents. The Board confirmed during redeliberations of the 2012 Exposure Draft that an entity applying the liquidation basis of accounting should recognize those items such that net assets in liquidation include all expected proceeds. The Board specified that an entity need not disaggregate those items. Additionally, those items should be measured at their gross amounts (that is, expected selling costs should be included in the accrual of estimated disposal costs as described in paragraph 205-30-25-6).

## Measurement

BC13. The Board understands that the recognition and measurement requirements for assets and other items recognized like assets (for example, previously unrecognized trademarks) when using the liquidation basis of accounting are inconsistent with general measurement concepts for general purpose financial reporting under FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting, and Chapter 3, Qualitative Characteristics of Useful Financial Information*. However, Concepts Statement 8 states that general purpose financial reports are not designed to meet all specialized needs. The

Board believes that financial statements that are prepared using the liquidation basis of accounting provide users of those financial statements with specialized information because the emphasis shifts from reporting about the entity's economic performance and position to reporting about the amount of cash or other consideration that an investor might reasonably expect to receive after liquidation. Financial statements that are prepared using the liquidation basis of accounting should convey information about the amount of cash or other consideration that an entity expects to collect and the amount that the entity is obligated or expects to be obligated (in the case of the accruals described in paragraphs 205-30-25-6 and 25-7) to pay during the course of liquidation.

BC14. Assets are required to be measured at the amount of proceeds that an entity expects it will collect from the disposal or settlement (for example, in the case of accounts receivable) of those items. This measurement may differ from fair value (for example, because it does not assume that the related dispositions would be conducted in an orderly manner). The Board acknowledges that in some circumstances a fair value measurement will approximate the cash that an entity expects to collect. In those cases, an entity would not be precluded from measuring those assets at fair value. However, the Board does not intend that fair value would be used to measure all assets.

BC15. The Board decided that in applying the liquidation basis of accounting an entity should continue to follow otherwise applicable U.S. GAAP (including recognition requirements) for its liabilities or other obligations (excluding the accrual of estimated disposal costs as described in paragraph 205-30-25-6 and expected income and expenses as described in paragraph 205-30-25-7). The Board observed that unless it was legally released from having to pay a liability, an entity generally would not be able to estimate the amount that it would be required to pay in any meaningful way. Consequently, the Board decided that liabilities should not be written down under the liquidation basis until legally forgiven. Although the measurement basis for an entity's liabilities will not change when the entity determines that liquidation is imminent, the Board expects that this determination could change an entity's measurement assumptions and, therefore, might affect the amounts recognized in the statement of net assets in liquidation. For example, as a result of its determination that liquidation is imminent, the entity might conclude that it would be required to pay a particular liability earlier than it had previously contemplated.

BC16. The Board acknowledged that the measurements required when using the liquidation basis of accounting might require estimation. Consequently, an entity applying the liquidation basis of accounting should disclose the methods and significant assumptions used to measure its assets and liabilities and the type and amount of costs and income accrued, including the time horizon of accrual.

## Presentation

BC17. The Board decided that it would require, at a minimum, a statement of net assets in liquidation and a statement of changes in net assets in liquidation. The Board decided to require a statement of changes in net assets in liquidation instead of a statement of comprehensive income because it considers the former to be more relevant to users of the financial statements of an entity that is in liquidation. While an entity is not explicitly required to prepare a statement of net assets as of the date liquidation becomes imminent, the Board acknowledges that such information would be necessary so that the entity could prepare the statement of changes in net assets in liquidation for the first period in which liquidation becomes imminent.

BC18. The Board decided that the liquidation basis of accounting should be applied prospectively from the date liquidation becomes imminent. Several respondents to the 2012 Exposure Draft requested clarification about whether they should present information for the period of time that preceded the determination that liquidation is imminent (commonly referred to as a stub period). The Board decided not to provide guidance about whether an entity should present information about a stub period. The Board observed that the objective of the project was to provide guidance about when and how the entity should apply the liquidation basis of accounting. In deciding whether to present information about a stub period, an entity should consider the requirements of its regulator and the needs of any other anticipated users of the entity's financial statements.

## Effective Date and Transition

BC19. The Board decided that an entity using the liquidation basis of accounting for the first time should apply the amendments in this Update prospectively as of the date when liquidation becomes imminent. The Board considered requiring a cumulative-effect adjustment at that date. The Board decided not to require a cumulative-effect adjustment if the entity does not present a stub period as discussed in paragraph BC18 because that adjustment would not be relevant in those circumstances.

BC20. An entity need not comply with the amendments in this Update if it was using the liquidation basis of accounting as of the effective date under other Topics that provide guidance about when and how to apply the liquidation basis of accounting (for example, terminating employee benefit plans). All other entities that were using the liquidation basis of accounting as of the effective date of the Update should record a cumulative-effect adjustment to comply with the amendments in this Update as of the date of adoption.

BC21. The Board considered specifying an earlier effective date (that is, reporting periods beginning after September 15, 2013) but ultimately decided to delay the effective date by one quarter to allow enough time for the guidance to permeate audit literature and to avoid accidental noncompliance. The Board observed that because many nonpublic entities do not prepare interim financial statements, the effective date essentially provides those entities with an additional year before they are required to comply with the amendments in this Update.

## Benefits and Costs

BC22. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC23. Throughout the liquidation basis of accounting project, the Board carefully analyzed the costs and benefits of various paths forward. During its redeliberations, the Board remained aware that entities applying the guidance will likely be in dire financial condition. The Update establishes a principles-based approach for the following major topics:

- a. When an entity should transition to the liquidation basis of accounting
- b. How it should measure assets, liabilities, and other items (for example, trademarks) under the liquidation basis of accounting
- c. Information that an entity should disclose in financial statements prepared using the liquidation basis of accounting.

BC24. The guidance about when and how to apply the liquidation basis of accounting addresses an area in which there is currently minimal guidance. During outreach, several stakeholders noted that there is significant diversity in practice despite how infrequently the liquidation basis of accounting is used. Consequently, the Board decided that the primary benefit of this guidance is that it will result in more consistent application. Furthermore, financial statements prepared using the liquidation basis of accounting allow investors and other claimants to estimate more precisely how much they can reasonably expect to recover during an entity's liquidation.

BC25. The Board anticipates that the costs to comply with the Update will be substantially limited to the costs required to perform the remeasurements of an entity's assets and/or other items and estimating the accruals for income or expense expected during liquidation. In many cases (for example, when there is an observable market price), estimating those amounts will be straightforward. Additionally, an entity using the liquidation basis of accounting will likely have engaged in recent discussions or received offers from third parties that would enable it to easily remeasure its assets or saleable intangible items.

## Amendments to the XBRL Taxonomy

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The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (UGT). Those changes, which will be incorporated into the proposed 2014 UGT, are available for public comment at [www.fasb.org](http://www.fasb.org), and finalized as part of the annual release process starting in September 2013.