

October 16, 2012

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

By e-mail: [director@fasb.org](mailto:director@fasb.org)

**Re: Proposed Accounting Standards Update – Financial Instruments (Topic 825):  
*Disclosures about Liquidity Risk and Interest Rate Risk***

**(File Reference No. 2012-200)**

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 28,000 CPAs in public practice, industry, government and education, welcomes the opportunity to comment on the above captioned exposure draft.

The NYSSCPA's Financial Accounting Standards Committee deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with us, please contact J. Roger Donohue, Chair of the Financial Accounting Standards Committee at (917) 887-7809, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

  
Gail M. Kinsella

President

Attachment

**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON**

**PROPOSED ACCOUNTING STANDARDS UPDATE – FINANCIAL INSTRUMENTS  
(TOPIC 825); *DISCLOSURES ABOUT LIQUIDITY RISK AND INTEREST RATE RISK***

**(FILE REFERENCE NO. 2012-200)**

**October 16, 2012**

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# New York State Society of Certified Public Accountants

## Comments on

### **Proposed Accounting Standards Update – Financial Instruments (Topic 825): *Disclosures about Liquidity Risk and Interest Rate Risk* (File Reference No. 2012-200)**

#### **General Comments**

The purpose of the Financial Accounting Standards Board's (the "Board's") proposed Accounting Standards Update ("proposed ASU"), as presented in the "Summary and Questions for Respondents" section, is to convey information about a financial instrument's inherent risks and the broader risks to which an entity is exposed. The Board requires all entities to provide certain liquidity risk disclosures, but does not require entities that are not financial institutions to provide interest rate risk disclosures.

The Board should consider responses to its recent Discussion Paper, the Invitation to Comment, *Disclosure Framework* ("ITC"), before issuing this ASU as final. This ASU appears to implement the ITC before the issuance of any related guidance. For example, both the proposed ASU and the ITC address the disclosure of information on the reporting entity's liquidity. The proposed ASU paragraph ASC 825-10-50-23D notes that liquidity risk disclosures are intended to convey the risk that an entity will encounter difficulty in fulfilling obligations associated with financial liabilities that are settled by delivering cash or another financial asset. In addition, the proposed ASU paragraph ASC 825-10-50-23M requires entities that are not financial institutions to provide a table presenting the entities' expected financial cash flow obligations. The ITC Question L2 recommends disclosure of counterparty performance risk, which is an important part of determining liquidity risk, and the estimated amounts and timing of future cash flows that are contractually specified but are anticipated or otherwise probable.

Furthermore, the proposed ASU needs to present clearly certain disclosure requirements. For example, ASC 825-10-50-2A asserts that the disclosure guidance in paragraphs 825-10-50-23A through 50-23AF applies to all entities. Paragraph 825-10-50-23A contradicts this by asserting that the liquidity risk disclosures in paragraphs 825-10-50-23E through 50-23K and interest rate risk disclosures in paragraphs 825-10-50-23W through 50-23AF apply only to financial institutions. In addition, the liquidity risk disclosures in paragraphs 825-10-50-23M through 50-23R only apply to entities that are not financial institutions. The liquidity risk disclosures in paragraphs 825-10-50-23S through 50-23V apply to all entities. In addition, the Board should present in ASC 825 those disclosure requirements applicable to all entities and industry specific requirements in the relevant industry ASC topics. This would render the ASU more understandable to non-financial institution users and would be consistent with the Board's overall goal of making the ASC easier to read, interpret and understand U.S. Generally Accepted Accounting Principles.

Our responses to selected questions are as follows.

## Questions for Preparers and Auditors—Liquidity Risk

**Question 2: For an entity that is not a financial institution, the proposed amendments would require a cash flow obligations table that includes the expected maturities of an entity's obligations. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?**

**Response:**

The Board needs to identify the specific cash obligations covered in the scope of the proposed ASU. Most entities should have information on the amounts and timing of payments of cash obligations related to written contracts. The concept of expected maturities, which we understand to mean expected cash flows to be required under the contracts (including variable terms), as opposed to contractual maturities, suggests the proposed ASU includes cash obligations, the timing of which and amounts, are not specified in contracts. For example, the amount of interest due from variable interest debt is dependent on various economic conditions—many of which are uncertain at any given date. In addition, future cash obligations of commitments and derivatives presented in Example 6 (ASC 825-10-55-5D) are contingent on future market events, and are highly subjective and subject to change. Our response to Question 3 below expands upon this position.

**Question 3: The proposed amendments would require information about expected maturities for financial assets and financial liabilities to highlight liquidity risk. *Expected maturity* is the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations) rather than an entity's expected timing of the sale or transfer of the instrument. Do you agree that the term *expected maturity* is more meaningful than the term *contractual maturity* in the context of the proposed liquidity risk disclosures? If not, please explain the reasons and suggest an alternative approach.**

**Response:**

Paragraph 825-10-50-23D states that the purpose of liquidity risk disclosures is “to convey the risk that an entity will encounter difficulty in fulfilling obligations associated with financial liabilities that are settled by delivering cash or another financial asset.” The use of expected maturities would result in a significant diversity in practice and create potentially misleading financial statements. Contractual maturities convey information on when the entity is required to settle the liability to avoid a breach of contract. Expected maturities convey when the entity expects to settle the liability which may be a different date than the contractual obligation.

To our knowledge, most entities intend to avoid a breach of contract and may be tempted to disclose expected maturities in a manner to avoid the appearance of such an event. For example, an entity may intend to extend long-term debt that has a balloon final payment due in two years, and the entity has a commitment from the bank to obtain funds that would be used to repay the balloon payment of the original debt.

Paragraph 825-10-50-23R attempts to address these concerns by requiring entities that are not financial institutions to explain the significant assumptions used in estimating the expected timing of cash flow obligations if they differ significantly from the contractual maturities. In our experience, such explanations are typically standardized language and uninformative. The entire matter could be resolved by basing such disclosures on contractual maturities.

The use of expected maturities is also inconsistent with the Board's overall goal of converging with International Financial Reporting Standards ("IFRS") which requires contractual maturities. The proposed ASU may include obligations not addressed in IFRS 7, *Financial Instruments: Disclosures*, such as those having no written contract as well as presenting the obligations' timing and amounts in different periods.

We support such disclosures reflecting revisions of contractual maturities that occur after the date of the statement of financial position but before issuance of the financial statements.

**Question 4: The proposed amendments would require a quantitative disclosure of an entity's available liquid funds, as discussed in paragraphs 825-10-50-23S through 50-23V. Do you foresee any significant operational concerns or constraints in complying with this requirement? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?**

**Response:**

The proposed ASU limits the disclosure of future sources of funds available to settle future cash obligations to those funds generated from financial assets existing at the balance sheet date. This presentation is incomplete because it does not address the use of cash generated by operating activities to settle future cash obligations. The omission of cash generated by operating results provides a misleading presentation of liquidity risk in that it favors entities with significant financial instrument portfolios, such as financial institutions, over other operating entities.

A large number of private entities generate a significant portion of their funds from the results of operations, and use those funds to settle future cash obligations. For example, mortgage principal and interest due on commercial real estate is settled typically using net proceeds from tenant leases. Similarly, the obligations from a minimum purchase agreement related to inventory are settled by sales of that inventory. The omission of cash obtained from operations would result in those entities understating cash available to settle obligations.

The inclusion of funds generated by operations in the proposed disclosure is not a feasible approach. Future operating financial information may be considered to be a financial forecast. The uncertainty of forecasted financial transactions is reflected in current AICPA attestation literature that permits such information to be presented either as a point estimate or a range. As a result, many preparers are reluctant to disclose and auditors to opine on this information.

Paragraph 825-10-50-23S introduces a new term—"high-quality liquid assets," without proposing an amendment defining that term in the Master Glossary. Paragraph 825-10-50-23T describes "high-quality liquid assets" as those free from restrictions, are readily convertible to cash and include cash, cash equivalents, unpledged liquid assets, and borrowing availability,

such as loan commitments and other lines of credit. However, the attribute “free from restrictions” may be overly restrictive for entities that are not financial institutions. For example, the following restricted assets may be available to meet future cash obligations:

- Future draw downs of construction loans are restricted to signed construction contracts.
- Certain loans, such as those associated with Housing and Urban Development projects, require reserve (restricted) funds to service the debt and pay certain operating expenses, such as repairs and maintenance.
- Not-for-profit entities receive temporarily restricted contributions which eventually are available for operations.

## Questions for All Respondents

**Question 20: The amendments in this proposed Update would apply to all entities. Are there any entities, such as nonpublic entities, that should not be within the scope of this proposed Update? If yes, please identify the entities and explain why.**

### **Response:**

The Board should limit the scope of this proposed ASU to public financial institutions in the 94X ASC Topics. The utility of the proposed disclosures by other entities, including not-for-profit entities, is questionable. These entities often use financial instruments to supplement the financing of their current operations. As noted in the Summary, these entities “generally do not have a strategic imperative to manage the maturities of their financial assets and financial liabilities and often settle financial liabilities with funds from operations.” Our response to Question 4 notes that the proposed disclosures ignore the effect of future operations on future liquidity. In addition, our response to Question 3 notes that the disclosure of expected, as opposed to contractual, maturities present a potentially misleading presentation of liquidity and is also inconsistent with convergence with IFRS.

Because the desire for this information comes primarily from investors and analysts of public companies, this guidance should be optional for all nonpublic companies. Many nonpublic and small public operating companies do not have the expertise to implement this proposal and would either have to hire consultants or add staff with the necessary skills. This would be a significant burden on entities struggling in the current economic environment. For example, many smaller community banks that do not follow the approaches presented in the proposed ASU may find these disclosures a significant cost burden. Such cost burden may become a factor affecting action such as pushing community banks to merge with larger institutions (as opposed to merely reporting information). The U.S. economy, heavily dependent on small businesses to create jobs, will suffer if this new accounting standard reduces the number of community banks lending to smaller businesses.

Furthermore, with the standards existing for public companies, the standards would still be available for individual users to negotiate for private entities to apply voluntarily.

Nonpublic companies should be encouraged to provide information on how they assess their liquidity and interest rate risks. This will provide insights in how these companies view such

risks.

Public companies should also be encouraged to provide their own metrics (though the response may be limited due to concerns about releasing proprietary information).

**Question 21: Although the proposed amendments do not have an effective date, the Board intends to address the needs of users of financial statements for more information about liquidity risk and interest rate risk. Therefore, the Board will strive to make these proposed amendments effective on a timely basis. How much time do you think stakeholders would require to prepare for and implement the amendments in this proposed Update? Should nonpublic entities be provided with a delayed effective date? If so, how long of a delay should be permitted and why? Are there specific amendments that would require more time to implement than others? If so, please identify which ones and explain why.**

**Response:**

If nonpublic companies are not given the option to comply, as previously recommended, the Board should give such nonpublic companies at least a one year deferral from adoption to allow them to learn from the information to be provided by public companies.