MEMO# 25231

May 31, 2011

ICI Comment Letter on FASB and IASB Draft Proposal That Would Eliminate "Cash Equivalents" From Financial Reporting

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 9-11
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 35-11 RE: ICI COMMENT LETTER ON FASB AND IASB DRAFT PROPOSAL THAT WOULD ELIMINATE "CASH EQUIVALENTS" FROM FINANCIAL REPORTING

The Institute recently filed the attached comment letter with the Financial Accounting Standards Board and the International Accounting Standards Board on their joint Financial Statement Presentation project. The project would, among other things, eliminate the concept of “cash equivalents” from financial reporting. Under current accounting standards applied by operating companies, cash and cash equivalents (e.g., Treasury bills, commercial paper, and shares issued by money market funds) are presented in a single line item in the balance sheet (i.e., “cash and cash equivalents”). The joint project would cause instruments currently characterized as cash equivalents to be presented as part of “short-term investments” (i.e., debt securities maturing in one year or less, without regard to credit quality). Under the joint project, “cash” would be limited to currency on hand and demand deposits with banks and similar financial institutions. The Institute’s comment letter relates to a “staff draft” of an exposure draft. We understand that the actual exposure draft proposing this change will not be issued until 2012.

The Institute’s comment letter argues that the proposed change would misrepresent a company’s liquidity position. Further, the comment letter argues that other instruments that may be included in short-term investments may present significantly greater risks than money market funds. The comment letter urges that the concept of cash equivalents be retained and that such instruments be presented as a separate line item on the balance sheet. A separate category for cash equivalents as recommended by the Institute would address any concerns regarding aggregation of cash and cash equivalents while avoiding the problems that would result if cash equivalents are eliminated and made a part of short-term investments.

The Institute’s comment letter describes the risk-limiting conditions included in Rule 2a-7. The letter also describes how Rule 2a-7 was recently amended to further strengthen investor protections through provisions addressing enhanced liquidity, improved credit quality, stress testing, “know your investor” procedures, shorter portfolio maturities, and more detailed and more frequent disclosures. The letter also notes that industry and policy makers are continuing to consider ways to further bolster money market funds’ resilience to severe market stress.

The comment letter notes the rationale for the proposed change – cash equivalents do not possess the same risk characteristics as cash – suggesting that they should not be presented in the same line item as cash. The comment letter indicates, however, that the aggregation of money market funds and with other instruments that qualify as short-term investments results in the same problem that the project seeks to address (i.e., aggregating dissimilar items). The letter also describes how demand deposits that exceed deposit insurance limits present liquidity and counter-party risks.

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Attachment