MEMO# 24541

September 13, 2010

IASB and FASB Staffs' Proposal to Eliminate "Cash Equivalents"; Member Call on September 23

[24541]

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TO: MONEY MARKET FUNDS ADVISORY COMMITTEE No. 41-10 RE: IASB AND FASB STAFFS' PROPOSAL TO ELIMINATE "CASH EQUIVALENTS"; MEMBER CALL ON SEPTEMBER 23

On July 1, 2010, the staffs of the International Accounting Standards Board ("IASB") and the Financial Standards Accounting Board ("FASB") issued a draft of an exposure draft for the Boards' joint project to develop a standard on financial statement presentation ("paper"). [1] One of the Boards' proposed changes is the elimination of the concept of "cash equivalents" which would mean such instruments would be presented in "short-term investments." [2] The paper reflects the tentative decisions of the Boards; however, they are engaging in additional outreach activities before publishing an exposure draft in early 2011. Although the Boards are not formally inviting comments, they welcome input from interested parties.

Under Statement of Financial Accounting Standards No. 95, the term "cash-equivalents" refers to short-term, highly liquid investments that are both: (a) readily convertible to known amounts of cash; [and] (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates." [3] Generally cash equivalents are short-term, highly liquid instruments such as treasury bills, commercial paper, short-term certificates of deposit and money market funds. As a result of recent market events, some are questioning the stature of these instruments, including money market funds, as cash-like.

FASB and IASB argue that the new classification will help users better assess an entity's ability to meet its financial commitments as they become due and to invest in business opportunities. Although an entity is typically able to convert cash equivalents to cash quickly, the Boards claim, no short-term investment can have all of the characteristics of currency on hand and on-demand deposits. For example, regardless of how near its maturity, a short-term investment is subject to some risk of price change attributable to sudden changes in the credit environment or the perceived credit quality of the issuer. Thus, presenting cash equivalents separately from cash avoids grouping in the same line item what the Boards view as dissimilar assets and, therefore, better reflects the liquidity position of the company. In response to the argument that an entity should present cash and cash equivalents together because cash equivalents are often a critical component of an entity's cash management functions, the Boards argue that although cash and cash equivalents may be managed similarly, cash equivalents have different economic characteristics and, thus, should not be presented with cash. The Boards are also proposing that information about any limitations and restrictions on the availability of cash and short-term investments be disclosed in notes to financial statements. In response to the Boards' arguments on the elimination of cash equivalents, some assert that the reclassification of short-term, highly liquid assets will not reflect, and may in fact misrepresent, the purpose for which these assets are held, e.g., money market funds are not used to generate investment returns but rather to maintain liquidity within the entity. [4]

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We will have a member call to discuss this paper on September 23, 2010 at 3 p.m. (EST). The dial-in number from the United States is 1-800-369-1742 and the participant passcode is 12678.

Please respond to Ruth Tadesse at rtadesse@ici.org if you intend to participate. If you have any questions or comments, you can reach me at 202-326-5813 or solson@ici.org.

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endnotes

[1] Staff Draft of Exposure Draft IFRS X Financial Statement Presentation (July 1, 2010) available at http://www.ifrs.org/NR/rdonlyres/1CCDE163-47FF-4563-A6DD-5A7EFFA80E08/0/FSP_standard_BC_and_guidance.pdf

[2] Short-term investments are typically investments that a company has made that will expire within one year.

[3] Statement of Financial Accounting Standards No. 95, available at www.fasb.org. "Cash equivalents" are generally investments with original maturities (not remaining maturities) of three months or less. However, not all investments that qualify are required to be treated as a cash equivalent. Generally, an enterprise is expected to establish and disclose its policy concerning which short-term, highly liquid investments will be treated as cash equivalents.

[4] The Institutional Money Market Fund Association ("IMMFA"), a trade association representing European triple-A rated money market funds, submitted a comment letter, dated September 9, 2010, arguing this point. IMMFA asserted that money market funds are not used to generate returns and therefore it would be inconsistent, and potentially misleading, to require money market funds to be recorded under the investing category

within a cash flow statement. IMMFA recommended that if it is necessary to distinguish between cash and cash equivalents, then cash equivalents as a concept should remain but be separately identifiable from cash.