

COMMENT LETTER

October 19, 2012

ICI Comment Letter On FASB Liquidation Basis Accounting Proposal (pdf)

10/19/201210/19/201210/19/2012 October 19, 2012 Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116 Re: The Liquidation Basis of Accounting File Reference No. 2012-210 Dear Ms. Cosper: The Investment Company Institute¹ is pleased to offer comments on the proposed FASB Accounting Standards Update, The Liquidation Basis of Accounting (ASU or Proposal). The ASU would require investment companies and other entities to prepare their financial statements using the liquidation basis of accounting when liquidation is imminent. The Proposal would require investment companies to measure their assets and liabilities at the amount of cash the fund expects to receive or pay during the course of liquidation. Investment companies would also be required to accrue and separately present the costs they expect to incur and the income they expect to earn during the duration of the liquidation, including any costs associated with settlement of their assets and liabilities. We are concerned that the Proposal's requirement to 1) measure assets at the amount of cash expected to be collected, and 2) immediately recognize future income and expense expected to be collected/paid during the duration of the liquidation, may conflict with measurement and recognition requirements applicable to SEC registered investment companies. Accordingly, we recommend that SEC registered investment companies be excluded from the scope of the Proposal. We elaborate on our comments below. 1 The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$13.5 trillion and serve over 90 million shareholders. 2 Measurement The Proposal, at 205-30-30-1, indicates that assets and liabilities shall be measured to reflect the estimated amount of cash or other consideration that an entity expects to collect or pay to carry out its plan of liquidation. BC9 indicates that this measurement differs from fair value because it does not assume that the related dispositions would be conducted in an orderly manner and that an entity that typically measures its assets at fair value would record adjustments that reconcile fair value to the amount of cash expected to be recovered. We are concerned that the ASU may conflict with SEC regulations applicable to registered investment companies. In particular, Rule 6-03(d) of Regulation S-X requires funds to reflect investments at value in their financial statements. Value for this purpose is defined in Section 2(a)(41) of the Investment Company Act of 1940 ("1940 Act") to mean i) market value for those securities that have readily available market quotations, and ii) fair value as determined in good faith by the board of directors for all other securities. Section 2(a)(41) and related Commission

guidance is generally understood as being consistent with GAAP fair value measurement guidance articulated in Topic 820. Accordingly, any move from fair value measurement to liquidation basis measurement raises important regulatory considerations for registered investment companies. The Proposal's requirement to measure assets at the amount of cash the entity expects to collect and the notion that liquidating transactions may take place in a disorderly manner appear to be premised on the notion that the fund would necessarily sell all of its securities shortly after the its board decides to liquidate. We disagree with this premise. Fund liquidations are structured so as to provide the fund with an opportunity to avoid disorderly sales and maximize the value of the portfolio. In this context we believe it is important to note that the nature of fund's assets and liabilities are typically very different than other types of companies. SEC registered funds generally are pools of securities with few significant liabilities or cash flow obligations. The absence of significant liabilities or cash flow obligations should afford the fund with the flexibility to structure the liquidation period in this manner.

Income and Expense Recognition The ASU at 205-30-30-3 would require income and expenses that the fund expects to earn or incur during the duration of the liquidation period to be recognized at the time the fund decides to liquidate. We are concerned that the Proposal's requirement to immediately recognize future income conflicts with Rule 6-03(g) of Regulation S-X, which requires dividend income to be recognized on the ex-dividend date and interest income to be accrued daily. We also have concerns that recognizing future income could result in assets being recorded at amounts greater than their fair values. In addition, we believe it would be difficult to estimate the amount of income to be recognized, insofar as it cannot be known in advance exactly when securities (on which the income is to be accrued) will be sold. At 205-30-30-2 the Proposal indicates that estimated costs to dispose of assets or liabilities shall be accrued and presented in the aggregate separate from the measurement of assets and liabilities. We believe costs directly associated with the liquidation (e.g., legal, shareholder communication, 3 shareholder meeting if required, etc.) should be immediately recognized. We do not believe, however, that costs for ongoing services provided to the fund (e.g., management fees) should be immediately recognized. Instead, we believe these costs should continue to be accrued daily. Recognition of fees for management services yet to be received may cause the fair value of the fund's net assets to be understated. For open-end mutual funds that redeem shares daily, the issues described above are broader than financial reporting. These issues may also affect the daily calculation of the fund's net asset value, the price per share at which shareholders may redeem their investment. Indeed, 1940 Act Rule 2a-4 requires the daily NAV calculation for open-end funds to reflect:

- portfolio securities at their current market value, where market quotations are readily available;
- portfolio securities at fair value as determined in good faith by the board of directors, where market quotations are not readily available;
- daily accrual of expenses;
- dividends receivable on portfolio securities; and
- daily accrual of interest income.

Open-end fund shares would continue to be redeemable at the shareholder's option during the liquidation period. We believe accelerating recognition of income and expenses may cause net asset value per share to be misstated. We also have concerns that measuring portfolio securities on a liquidation basis, rather than fair value, may also cause net asset value per share to be misstated. While it is unclear that open-end funds would apply the concepts in the Proposal to their daily NAV calculation, the ASU at the very least raises the possibility of two separate NAVs – one for daily shareholder transactions consistent with Rule 2a-4 and one for financial reporting purposes prepared under the liquidation basis of accounting. We believe this scenario would be confusing to shareholders. ***** If you have any questions on our comments or require additional information, please contact the undersigned at 202/326-5851 or smith@ici.org. Sincerely, Gregory M. Smith Director – Fund Accounting cc: Jaime Eichen, Chief Accountant Division of Investment Management

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