**FASB'S Proposed Accounting Standards Update, Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk**

*Background*

This proposed Update is intended to provide users of financial statements with additional decision-useful information about an entity's liquidity risk and interest rate risk. The Board also considered other market risks, such as movements in commodity prices, equity prices, and foreign exchange rates but decided that liquidity risk and interest rate risk were the areas of risk for which users expressed the greatest demand for improved disclosures.

The amendments in this proposed Update would apply to all reporting entities. Some proposed amendments would apply only to financial institutions, and others would apply only to entities that are not financial institutions.

With the goal of providing users of financial statements with more decision-useful information about entity-level exposures to liquidity risk and interest rate risk, the Board proposes the following disclosures, depending on the characteristics of the reporting entity.

*Liquidity Risk Disclosures: The proposed liquidity risk disclosures would provide information about the risks and uncertainties that a reporting entity might encounter in meeting its financial obligations. The proposed amendments would require an entity that is not a financial institution to disclose in a table its expected cash flow obligations disaggregated by their expected maturities. Furthermore, in a separate table, an entity that is not a financial institution would be required to disclose its available liquid funds*

*CFMA's Response*

Our response is reflective of positions represented within CFMA and includes the following recommendations:

- The existing exemption should be carried forward to the new disclosure guidance.
- The concept of materiality should be introduced in the proposed ASU for derivative instruments to further lessen the financial burden on nonpublic entities.
- As users of the financial statements for nonpublic entities already have the ability to request additional information related to liquidity, if and when it is necessary, to supplement the basic financial statements, the new disclosure requirements are unnecessary.
- The definition of "financial institutions" should be revised to include captive insurance arrangements, specifically when the captive is wholly-owned, and should also incorporate the concept of materiality.
- The above recommendations would be suggested in the event the amendment would apply to nonpublic entities and prospective implementation should be required/permitted should the amendment apply to nonpublic entities.

Additionally, in focusing on the liquidity disclosures where the amendment would require the use of 'expected maturity' dates for the liquidity disclosures surrounding debt, leases and other commitments as well as financial assets and whereas this concept would be in lieu of using contractual maturities of such instruments and would require management's judgments and estimates to be incorporated into the amounts disclosed (ie – the buckets/maturity tables), our response notes the following:

- This concept would be difficult for preparers as well as auditors. Developing and auditing these assumptions would increase costs and not provide a related tangible benefit.

- While developing assumptions for liabilities may not present as many challenges, developing assumptions for assets would create unnecessary complexities.
- The use of contractual maturities combined with narrative disclosures surrounding the expected maturities (calls, puts, prepayments, etc.) would be more cost effective and efficient and provide the necessary information.

CONSTRUCTION FINANCIAL MANAGEMENT ASSOCIATION
*The Source & Resource for Construction Financial Excellence*

September 24, 2012

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Via e-mail

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

Dear Financial Accounting Standards Board:

The Construction Financial Management Association (CFMA) is "The Source & Resource for Construction Financial Professionals" and the only nonprofit organization dedicated to serving the construction financial professional. Headquartered in Princeton, NJ, CFMA currently has nearly 6,700 members in 89 chapters throughout the U.S. and Canada.

Established in 1981, CFMA's General Members represent all types of contractors, as well as developers, construction managers, architects, engineers, principals, and material and equipment suppliers. Associate Members include the accounting, insurance, surety, software, legal, and banking specialists who serve the construction industry.

CFMA is pleased to take this opportunity to comment on the Proposed Accounting Standards Update, Financial Instruments (Topic 825): Disclosures about Liquidity Risk and Interest Rate Risk (the "Proposed ASU").



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## General Comments/Observations

Before providing responses to specific questions, we would like to present general comments regarding the Proposed ASU. These comments encompass the views of CFMA members who are financial statement preparers, auditors, and users.

*Exemptions*

The Proposed ASU will be an amendment to the existing disclosure requirements surrounding financial instruments. Existing requirements exempt nonpublic entities that have a) total assets of less than $100 million on the date of the financial statements, and b) have no instruments accounted for as a derivative instrument. However, the disclosure guidance in this proposed amendment will be required of all entities for annual reporting periods with no equivalent exemption provided. Therefore, we recommend that the Proposed ASU apply the existing exemption to the proposed disclosure requirements. We also recommend that the concept of materiality be introduced in the Proposed ASU to further lessen the financial reporting burden on nonpublic entities that have a simple, single derivative instrument such as a basic interest rate swap.

Our recommendation is based on the premise that the disclosures for nonpublic entities that would be required by the Proposed ASU (principally liquidity risk) are substantially provided under existing guidance for debt, leases, and other commitments. Additionally, users of the financial statements for nonpublic entities generally have the ability to request additional information related to liquidity, if and when it is necessary, to supplement the basic financial statements, rendering the proposed disclosure requirements unnecessary.

*Financial Institutions*

Interest rate disclosures to be required by the Proposed ASU would only apply to ‘financial institutions’ as defined. The Proposed ASU defines a financial institution as entities or reportable segments that either: 1) earn as a primary source of income, net interest income, or 2) provide insurance. Therefore, the interest rate disclosure requirements of the Proposed ASU would apply to entities that have a basic insurance captive structure that is consolidated with the reporting entities’ financial statements.

We recommend that the Proposed ASU apply the existing exemption as described above to the proposed disclosure requirements. We also recommend that the concept of materiality be introduced in the Proposed ASU to further lessen the financial reporting burden on nonpublic entities that have a simple captive insurance arrangement that would already be subject to separate statutory or other reporting requirements.

*Tax Distributions for Flow-Through Entities*

The Proposed ASU will require disclosure, in undiscounted amounts, of an entity’s cash flow obligations as outlined in paragraphs 825-10-50-23M through 50-23R with additional implementation guidance provided in Example 6. The language in the Proposed ASU currently includes off-balance sheet obligations, which can be broadly interpreted and encompass minimum lease payments, payments under derivative contracts and guarantees, payments to various taxing jurisdictions, as well as others. We have a concern that non-taxable, or ‘flow-through’ entities, may be unnecessarily burdened by this requirement should it be interpreted to include *expected* future distributions to owners for payment of individual tax obligations.

Flow-through entities typically make distributions to owners subsequent to year-end for payment of $4^{th}$ quarter estimated tax payments. By nature, these payments are not direct obligations of the entity, but nonetheless, are a necessary consequence of conducting business through the use of a flow-through entity structure. To determine the amount of estimated tax payments to be distributed, preparers must consider other activities of the owners that are outside of, and unrelated to, the entity. As a consequence, these estimates may not be determinable prior to publishing the financial statements and may require substantial judgment and estimation.

We do acknowledge that certain users desire to have preparers of financial statements of flow-through entities include a disclosure of their best estimate of future distributions to cover taxes on flow-through-related earnings along with the significant assumptions used to arrive at the amounts disclosed. We also recognize that certain users of financial statements undertake an effort to estimate these amounts themselves when evaluating the financial position of the flow-through entity in which operation is almost always based on incomplete data and/or inaccurate assumptions.

Nonetheless, there are a host of issues which must be evaluated in attempting to prepare a disclosure that is illuminating and not potentially misleading. Just a few examples of factors impacting the accuracy of such a disclosure include outside factors impacting the tax situation of the flow-through entity owners, which may not be known to the flow-through entity, significant deferred tax assets or liabilities of the flow-through entity which are not currently calculated, and personal wealth or liquidity of the flow-through entity owner, which may be used to satisfy tax obligations.

Accordingly, while we are sympathetic to the desires of users to have additional insight into future distributions to cover taxes on flow-through related earnings, we also believe that the complexity of this particular issue is something which should be separately deliberated because of its far-reaching scope.

We, therefore, recommend that the Proposed ASU be revised to exempt expected future distributions to owners for payment of individual tax obligations from the definition of an undiscounted, off-balance sheet, cash flow obligation until they are certain to occur. If such an exemption is not provided, we are concerned that flow-through entities will be expected to provide the equivalent of a full deferred tax calculation and disclosure, which could be more misleading than illuminating.

*Adoption and Implementation*
Finally, with regards to adoption and implementation of the Proposed ASU, we recommend the prospective adoption and implementation be required/permitted for nonpublic entities and that the time period for adoption be 1 year after the period required for public entities.

## ***Questions for Preparers and Auditors-Liquidity Risk***

**Question 1**: For a financial institution, the proposed amendments would require a liquidity gap table that includes the expected maturities of an entity’s financial assets and financial liabilities. 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?

***Answer:*** Not applicable to substantially all construction entities.

**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?

**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.

***Answer:*** *(Questions 2 and 3 are very similar for contractors and are answered here together.)* Much of this information is required by existing accounting guidance for debt, leases, and other commitments as well as financial assets, except for the introduction of the concept of using expected maturities. This concept would be in lieu of using contractual maturities of such instruments and would require the judgments and estimates of management to be incorporated into the amounts disclosed (i.e.; the buckets/maturity tables).

While disclosures that incorporate the concept of expected maturities for financial instruments may provide meaningful information to users, we believe that these benefits are marginal in comparison to the related costs. The concept of expected maturities will present significant challenges to preparers, as well as auditors, in developing and auditing the assumptions that would be used to determine the expected maturities and would increase costs disproportionate to any related tangible benefits. Developing such assumptions for financial assets would be particularly burdensome in trying to predict the behavior of third parties. The use of contractual maturities for cash flow and other quantitative disclosures combined with narrative disclosures surrounding the expected maturities (calls, puts, prepayments, etc.) would be more cost effective and efficient and still provide the necessary information.

**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?

***Answer:*** No significant operational concerns or constraints foreseen.

**Question 5:** For depository institutions, the proposed Update would require a time deposit table that includes the issuances and acquisitions of brokered deposits during the previous four fiscal quarters. 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?

***Answer:*** Not applicable to substantially all construction entities.

**Question 6**: As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to develop an understanding of your entity's exposure to liquidity risk? If not, what other information would better achieve this objective?

***Answer:*** While we agree that the Proposed ASU would provide sufficient information for users to understand liquidity risk, we believe that existing disclosure requirements provide essentially the same information. For example, the future maturities of debt for each of the 5 years subsequent to the balance sheet date, and in aggregate for periods thereafter, are disclosures that are currently required; whereas future maturities for each of the 4 quarters subsequent to the balance sheet date and for the 2$^{nd}$ fiscal year and 3$^{rd}$ through 5$^{th}$ fiscal years, combined, and thereafter, would be required by the Proposed ASU. The only difference in the disclosures will be the composition of the periods in the various ‘buckets’ that will be required.

## *Questions for Users—Liquidity Risk*

**Question 7**: Does the liquidity gap table described in paragraphs 825-10-50-23E through 50-23K provide decision-useful information about the liquidity risk of a financial institution? If yes, how would you use that information in analyzing a financial institution? If not, what information would be more useful?

***Answer:*** The liquidity gap table in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, is not applicable to substantially all construction entities.

**Question 8:** Does the cash flow obligations table described in paragraphs 825-10-50-23M through 50-23R provide decision-useful information about the liquidity risk of an entity that is not a financial institution? If yes, how would the information provided be used in your analysis of an entity that is not a financial institution? If not, what information would be more useful?

***Answer:*** Users of financial statements of nonpublic entities are generally satisfied with the disclosures surrounding cash flow obligations of an entity under existing disclosure guidance which require annual amounts for the 5 years subsequent to the date of the financial statements and in aggregate thereafter. The expanded disclosures that would be required by the Proposed ASU, in particular the quarterly information, does not provide incremental benefit, as such information is typically available to users upon request. Please refer to our responses to Questions 2 and 3 above for additional detail.

**Question 9:** Paragraphs 825-10-50-23S through 50-23V would require an entity to disclose its available liquid funds. Would this table provide decision-useful information in your analysis? If not, what information would be more useful?

***Answer:*** Disclosure of available liquid funds would provide decision-useful information, although such information is typically available to users upon request. In many cases, the available liquid funds are held by the user, typically the bank used by the reporting entity.

**Question 10:** Are the proposed time intervals in the tables appropriate to provide decision-useful information about an entity's liquidity risk? If not, what time intervals would you suggest? Do you believe that there are any reasons that these required time intervals should be different for financial institutions and entities that are not financial institutions?

***Answer:*** Users of financial statements of nonpublic entities are generally satisfied with the disclosures surrounding cash flow obligations of an entity under existing disclosure guidance which require annual amounts for the 5 years subsequent to the date of the financial statements and in aggregate thereafter. The expanded disclosures that would be required by the Proposed ASU, in particular the quarterly information, does not provide incremental benefit, as such information is typically available to users upon request. It is also our recommend that the disclosure requirements not be disaggregated beyond 5 years due to the uncertainty surrounding when such obligations would actually be repaid and what assets would be available to satisfy the repayment obligation.

**Question 11**: With respect to the time intervals, should further disaggregation beyond what is proposed in this Update be required to provide more decision-useful information to the extent that significant amounts are concentrated within a specific period (for example, if a significant amount of liabilities are due in Year 10 of the "past 5 years" time interval)? Please explain.

***Answer:*** Further disaggregation beyond what is required by this Proposed ASU would not provide decision-useful information based on the uncertainty of a number of events that could potentially transpire between the date of the financial statements and the future time periods. Prior to those future cash obligations coming due, entities will often refinance those existing obligations, modify and/or extend existing maturity schedules, or borrow additional funds, among a number of other possibilities.

**Question 12:** For depository institutions, the proposed Update would include a time deposit table that includes the issuances and acquisitions of brokered deposits during the previous four fiscal quarters.

Would this table provide decision-useful information in your analysis of depository institutions? If not, what information would be more useful?

***Answer:*** Not applicable to construction entities.

## *Questions for Preparers and Auditors—Interest Rate Risk*

**Question 13:** The interest rate risk disclosures in this proposed Update would require a repricing gap table. 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?

***Answer:*** The repricing gap table in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, is not applicable to substantially all construction entities.

**Question 14**: The interest rate risk disclosures in this proposed Update would include a sensitivity analysis of net income and shareholders' equity. Do you foresee any significant operational concerns or constraints in determining the effect of changes in interest rates on net income and shareholders' equity? If yes, what operational concerns or constraints do you foresee and what would you suggest to alleviate them?

***Answer:*** The sensitivity analysis in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, is not applicable to substantially all construction entities.

**Question 15**: As a preparer, do you feel that the proposed amendments would provide sufficient information for users of your financial statements to understand your entity's exposure to interest rate risk? If not, what other information would better achieve this objective?

***Answer:*** The interest rate risk disclosures in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, are not applicable to substantially all construction entities.

## *Questions for Users—Interest Rate Risk*

**Question 16:** Would the repricing gap analysis in paragraphs 825-10-50-23Y through 50-23AC provide decision-useful information in your analysis of financial institutions? If yes, how would this disclosure be helpful in your analysis? If not, what information would be useful?

***Answer:*** The repricing gap table in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, is not applicable to substantially all construction entities.

**Question 17:** Are the proposed time intervals in the repricing gap table in paragraphs 825-10-50-23AB through 50-23AC appropriate to provide decision-useful information about the interest rate risk to which a financial institution is exposed? If not, which time intervals would you suggest?

***Answer:*** The proposed time intervals in the repricing gap table in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, are not applicable to substantially all construction entities.

**Question 18:** The interest rate risk disclosures in the proposed Update would include a sensitivity analysis portraying the effects that specified charges in interest rates would have on net income and shareholders' equity. Currently, many banks and insurance companies provide a sensitivity analysis of the economic value of equity instead of shareholders' equity. A sensitivity analysis of economic value would include the changes in economic value of financial instruments measured at amortized cost, such as loans and deposits. A sensitivity analysis of shareholders' equity would only include those changes that affect shareholders' equity. Therefore, the changes in the economic value of financial instruments measured at amortized cost would not be reflected in the sensitivity analysis although changes in interest income would be reflected. Do you think that a sensitivity analysis of shareholders' equity would provide more decision-useful information than would a sensitivity analysis of economic value? Please discuss the reasons why or why not?

***Answer:*** The sensitivity analysis in the Proposed ASU will be required of entities that meet the definition of a 'financial institution' and; therefore, is not applicable to substantially all construction entities.

**Question 19:** Do you think it is appropriate that an entity that is not a financial institution would not be required to provide disclosures about interest rate risk? If not, why not and how would the information provided be used in your analysis of an entity that is not a financial institution?

***Answer:*** We agree that it is appropriate to exempt an entity that does not meet the definition of a 'financial institution' from the interest rate risk disclosures in the Proposed ASU.

### *Questions for All Respondents*

**Question 20:** The amendments in the 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?

***Answer:*** Please refer to the General Comments/Observations section found on page 2 of this comment letter where we recommend extension of the exemption currently available to certain nonpublic entities.

**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?

***Answer:*** We do not foresee any significant implementation issues for entities that do not qualify as a financial institution. We also do not have the appropriate perspective to comment on behalf of financial institutions. We recommend that the effective date for adoption and implementation of the Proposed ASU be 1 year subsequent to issuance for public entities and that the effective date for nonpublic entities be 2 years subsequent to issuance. The additional 1 year period for nonpublic entities would ease the financial burden of implementation. Nonpublic entities have access to limited resources and users of financial statements of nonpublic entities, upon request, generally have greater access to additional financial information beyond what is reported in the financial statements.

**Question 22:** Do you believe that any of the amendments in this proposed Update provide information that overlaps with the SEC's current disclosure requirements for public companies without providing incremental information? If yes, please identify which proposed amendments you believe overlap and discuss whether you believe that the costs in implementing the potentially overlapping amendments outweigh their benefits? Please explain why.

***Answer:*** We do believe that many of the disclosures that will be required by the Proposed ASU overlap those of the SEC. Specifically, Items 303 and 305 of Regulation S-K currently require disclosures about liquidity, capital resources, and market risks that are similar in nature to those in the Proposed ASU. While the disclosures in the Proposed ASU are more prescriptive, both have requirements surrounding future cash flow obligations, sensitivity to interest rate exposure, and available sources of liquidity to satisfy current and future obligations. Therefore, we believe that the benefits of implementation are marginal. We also believe that, for nonpublic entities, the disclosures required by the Proposed ASU are either substantially provided under existing GAAP or the applicable information is readily available to the users of those financial statements.

In closing, we respect the FASB's commitment to providing high-quality, operational financial reporting standards for financial statement preparers, auditors, and users. The due process afforded to those, such as CFMA, wishing to comment on standards affecting our constituency is an important and valuable part of this process. Again, we are grateful for your efforts and welcome the opportunity to meet with FASB to further discuss these concerns.

Respectfully submitted,

Stuart Binstock
CFMA
President & CEO