

## 2004 Guidance on “Other-Than-Temporary Impairment”

The FASB will reconsider in its entirety the EITF’s and all other guidance on disclosing, measuring, and recognizing other-than-temporary impairments of debt and equity securities. Until new guidance is issued, companies must continue to comply with the disclosure requirements of EITF 03-1 and all relevant measurement and recognition requirements in other accounting literature.<sup>1</sup>

The reconsideration of EITF 03-1 and related literature on impairments of debt and equity securities opens the door to revisions that could affect many companies. In September, the FASB delayed the guidance on impairment losses under EITF 03-1, but the delay did not include the disclosure provisions, which will remain in effect until the full reconsideration of the EITF 03-1 guidance is completed.<sup>2</sup> New measurement and recognition guidance had been expected to be in place by the end of the year. However, a full reconsideration of EITF 03-1 and related literature will take more time.

### Applicable Guidance on Measurement and Recognition

Companies holding investments should continue to apply existing requirements for evaluating whether an impairment is other-than-temporary in paragraph 16 of Statement 115, the related FASB staff Q&A, paragraphs 1-9 of EITF 03-1 and paragraph 6 of APB 18 for cost-method investments (relevant provisions of EITF 03-1 were not delayed for cost-method investments), APB 18 for equity-method investments, and EITF 99-20 for beneficial interests in securitized financial assets.<sup>3</sup> The SEC staff has reminded registrants that they remain subject to the provisions of SAB 59.<sup>4</sup> Companies evaluating whether an impairment is other-than-temporary under existing requirements should continue to consider the length of time a security has been impaired, the severity of the impairment, and the financial condition and near-term prospects of the issuer of the security.

## Alert

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<sup>1</sup> EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.

<sup>2</sup> FASB Staff Position EITF 03-1-1, Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,” September 30, 2004.

<sup>3</sup> FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, May 1993; FASB Staff Implementation Guide, A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers, November 1995; APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, March 1971; EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets.

<sup>4</sup> See staff speech at <http://www.sec.gov/news/speech/spch120604jmj.htm> and SEC Staff Accounting Bulletin No. 59, Accounting for Noncurrent Marketable Equity Securities, and SAB Topic 5.M, Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities.



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Department of Professional  
Practice—Audit and Risk Advisory  
(212) 909-5600

**Contributing authors:**

E. Michael Pierce  
Lisa M. Busedu

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## Disclosure Requirements

The still-effective disclosure requirements of EITF 03-1 apply only to annual financial statements. However, as is the case with any annual disclosures, the interim reports of SEC registrants could be affected by Regulation S-X's requirement to update annual disclosures if events subsequent to the end of the most recent fiscal year have materially affected the registrant.<sup>5</sup> *Defining Issues* No. 04-9 describes the required tabular and narrative disclosures for Statement 115 and 124 securities and disclosures about cost-method investments.<sup>6</sup>

## Potential Consequences of Reopening OTI Guidance

The Board might consider whether to mandate quantitative thresholds to determine the significance of an impairment — so-called “bright line” criteria. A draft FASB staff position issued in September asked whether the final guidance should provide such criteria. SAB 59 and the FASB staff Q&A require that both the severity and duration of an impairment should be considered in evaluating whether an impairment is other-than-temporary. The Board might consider quantitative thresholds for evaluating both severity and duration — for example, a decline of more than 5% in market value could be defined as severe and a decline of that magnitude over a period greater than nine months could be considered indicative of other-than-temporary impairment. However, an approach based on bright-line tests would run contrary to the FASB and SEC staff's expressed interest in developing more principles-based or objectives-oriented standards.

The reconsideration of EITF 03-1 is likely to cover the effect of a pattern of selling investments on the investor's assertion regarding its ability and intent to hold securities until a forecasted recovery of fair value (“tainting”). The question of tainting pertains to both the other-than-temporary evaluations and the held-to-maturity classifications of Statement-115 debt securities. The SEC staff recently observed that the two tainting assessments are different and each must be assessed based on the facts and circumstances.<sup>7</sup> Thus, a potential consequence of the Board's reconsideration of EITF 03-1 is the possibility that it may lead to changes in other Statement-115 requirements.

The FASB directed its staff to analyze the 240-plus comment letters received in response to the proposed staff position on EITF 03-1 issues and to present recommendations early in the first quarter of 2005.<sup>8</sup> The recommendations could range from fine-tuning EITF 03-1's requirements to changing Statement 115's classification and measurement principles, including the potential elimination of the available-for-sale or held-to-maturity classification.



EITF 03-1 has generated a great deal of attention, and it is likely to receive more. We believe that compliance with the current measurement and recognition guidance on other-than-temporary impairment will continue to receive regulatory scrutiny.

The descriptive and summary statements above are not intended to substitute for the texts of the cited FASB Statements and Staff Positions, EITF guidance, and SAB 59 and are not necessarily applicable to any company's particular circumstances. Companies applying requirements on accounting and disclosure for other-than-temporary impairments of securities should consult the texts of the documents and their accounting and legal advisors.

<sup>5</sup> Rule 10-01(a)(5).

<sup>6</sup> FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, November 1995. *Defining Issues* 04-9 is available at [http://www.kpmg.com/Rut2000\\_prod/Documents/9/di%2004\\_9.eitf%2003\\_1%20impairment.pdf](http://www.kpmg.com/Rut2000_prod/Documents/9/di%2004_9.eitf%2003_1%20impairment.pdf).

<sup>7</sup> See staff speech at <http://www.sec.gov/news/speech/spch120604jmj.htm>.

<sup>8</sup> Proposed FASB Staff Position EITF 03-1-a, *Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.”*