

FASB STAFF POSITION

Nos. FAS 115-1 and FAS 124-1

Title: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

Date Posted: November 3, 2005

Introduction

1. This FASB Staff Position (FSP) addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*. Appendix B to this FSP shows the amendments to those pronouncements.

Background and Scope

2. At its March 17 and 18, 2004 meeting, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.” At this same meeting, the EITF decided to discontinue discussion of an impairment model for investments subject to the equity method of accounting. Shortly thereafter, the Board was asked to provide implementation guidance on that consensus. In September 2004, the FASB staff issued proposed FSP EITF 03-1-a, “Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1.”

3. The comment period on that proposed FSP ended on October 29, 2004. The Board received over 250 comment letters. Most respondents requested that the Board rescind the consensus reached in Issue 03-1.

4. The guidance in this FSP is applicable for investments in:

- a. Debt and equity securities that are within the scope of Statement 115.
 - (1) As indicated in paragraph 127(b) of Statement 115, insurance companies are required to report equity securities at fair value even if they do not meet the scope criteria in paragraph 3 of Statement 115. Therefore, this FSP would apply to all equity securities held by insurance companies.
 - (2) Investors shall not “look through” the form of their investment to the nature of the securities held by an investee. For example, an investment in shares of a mutual fund that invests primarily in debt securities would be assessed for impairment as an equity security under this FSP.
 - (3) Some investments may require bifurcation and separate accounting for the host instrument and embedded derivative if the criteria of paragraph 12 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, are met. The bifurcated host instrument would be evaluated for other-than-temporary impairment in accordance with the guidance in this FSP if the bifurcated host instrument meets the scope of this FSP.
- b. Debt and equity securities that are within the scope of Statement 124 and that are held by an investor that reports a “performance indicator” as defined in the AICPA Accounting and Audit Guide, *Health Care Organizations*.
- c. Equity securities that are not subject to the scope of Statements 115 and 124 and not accounted for under the equity method pursuant to Opinion 18 and related interpretations (hereinafter referred to as “cost-method investments”).

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5. This FSP nullifies certain requirements of Issue 03-1 and supersedes EITF Topic No. D-44, “Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value.” This FSP specifically:

- a. Nullifies the requirements of paragraphs 10–18 of Issue 03-1
- b. Carries forward the requirements of paragraphs 8 and 9 of Issue 03-1 with respect to cost-method investments
- c. Carries forward the disclosure requirements included in paragraphs 21 and 22 of Issue 03-1 and related examples
- d. References existing other-than-temporary impairment guidance.

6. Paragraphs 7–15 discuss the three steps in determining when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss.

Application Guidance

Step 1: Determine Whether an Investment Is Impaired

7. Impairment shall be assessed at the individual security level (herein referred to as “an investment”).¹ An investment is impaired if the fair value of the investment is less than its cost.² Except as provided in paragraph 10, an investor shall assess whether an investment is impaired in each reporting period. For entities that issue interim financial statements, each interim period is a reporting period.

8. An investor shall not combine separate contracts (a debt security and a guarantee or other credit enhancement) for purposes of determining whether a debt security is impaired or can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost.

9. For investments other than cost-method investments (see paragraph 4(c)), if the fair value of the investment is less than its cost, proceed to Step 2.

10. Because the fair value of cost-method investments is not readily determinable, the evaluation of whether an investment is impaired shall be determined as follows:

- a. If an investor has estimated the fair value of a cost-method investment (for example, for disclosure under FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*), that estimate shall be used to determine if the investment is impaired for the reporting periods in which the investor estimates

¹Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt and equity securities. (For example, equity securities of an issuer bearing the same CUSIP number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the securities of the issuer.)

²Cost includes adjustments made to the cost basis of an investment for accretion, amortization, previous other-than-temporary impairments, and hedging.

- fair value. If the fair value of the investment is less than its cost, proceed to Step 2.
- b. For reporting periods in which an investor has not estimated the fair value of a cost-method investment,³ the investor shall evaluate whether an event or change in circumstances has occurred in that period that may have a significant adverse effect on the fair value of the investment (an “impairment indicator”). Impairment indicators include, but are not limited to:
- (1) A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
 - (2) A significant adverse change in the regulatory, economic, or technological environment of the investee
 - (3) A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
 - (4) A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment
 - (5) Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

11. In addition, if an investment was previously tested for impairment under Step 2 and the investor concluded that the investment was not other-than-temporarily impaired, the investor shall continue to evaluate whether the investment is impaired (that is, shall estimate the fair value of the investment) in each subsequent reporting period until either (a) the investment experiences a recovery of fair value up to (or beyond) its cost or (b) the investor recognizes an other-than-temporary impairment loss.

12. If an impairment indicator is present, the investor shall estimate the fair value of the investment. If the fair value of the investment is less than its cost, proceed to Step 2.

³For example, an investor may not estimate the fair value of a cost-method investment during a reporting period for Statement 107 disclosure because (a) Statement 107 requires disclosure only for annual reporting periods; (b) the investor determined that, in accordance with paragraphs 14 and 15 of Statement 107, it is not practicable to estimate the fair value of the investment; or (c) the investor is exempt from providing the disclosure under FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*.

Step 2: Evaluate Whether an Impairment Is Other Than Temporary

13. When the fair value of an investment is less than its cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is either temporary or other than temporary.⁴ An investor shall apply other guidance that is pertinent to the determination of whether an impairment is other than temporary, such as paragraph 16 of Statement 115 (which references SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*), paragraph 6 of Opinion 18, and EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets.”

14. In applying that guidance, questions sometimes arise about whether an investor shall recognize an other-than-temporary impairment only when it intends to sell a specifically identified available-for-sale debt or equity security at a loss shortly after the balance sheet date. When an investor has decided to sell an impaired available-for-sale security and the investor does not expect the fair value of the security to fully recover prior to the expected time of sale, the security shall be deemed other-than-temporarily impaired in the period in which the decision to sell is made. However, an investor shall recognize an impairment loss when the impairment is deemed other than temporary even if a decision to sell has not been made.

Step 3: If the Impairment Is Other Than Temporary, Recognize an Impairment Loss Equal to the Difference between the Investment’s Cost and Its Fair Value

15. If it is determined in Step 2 that the impairment is other than temporary, then an impairment loss shall be recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made. The measurement of the impairment shall not include partial recoveries subsequent to the balance sheet date. The fair value of the investment would then become the new cost basis of the investment and shall not be adjusted for subsequent recoveries in fair value.

⁴Other than temporary does not mean permanent.

Accounting for Debt Securities Subsequent to an Other-Than-Temporary Impairment

16. In periods subsequent to the recognition of an other-than-temporary impairment loss for debt securities,⁵ an investor shall account for the other-than-temporarily impaired debt security as if the debt security had been purchased on the measurement date of the other-than-temporary impairment. That is, the discount or reduced premium recorded for the debt security, based on the new cost basis, would be amortized over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows.

Disclosures

17. For all investments in an unrealized loss⁶ position, including those that fall within the scope of Issue 99-20, for which other-than-temporary impairments have not been recognized, an investor shall disclose the following in its annual financial statements:

- a. As of each date for which a statement of financial position is presented, quantitative information, aggregated by category of investment—each category of investment that the investor discloses in accordance with Statements 115 and 124 (see paragraph 4(b)) and cost-method investments—in tabular form:
 - (1) The aggregate related fair value of investments with unrealized losses
 - (2) The aggregate amount of unrealized losses (that is, the amount by which cost exceeds fair value).

The disclosures in (1) and (2) above shall be segregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer. The reference point for determining how long an investment has been in a continuous unrealized loss position is the balance sheet date of the reporting period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point would be the annual balance sheet date of the period during which the impairment was identified. The continuous unrealized loss position ceases upon either (a) the recognition of an other-than-temporary impairment or (b) the investor becoming aware of a recovery of fair value up to (or beyond) the cost of the investment during the period.

⁵This FSP does not address when a holder of a debt security would place a debt security on nonaccrual status or how to subsequently report income on a nonaccrual debt security.

⁶An unrealized loss is the amount by which the cost of an investment exceeds its fair value.

- b. As of the date of the most recent statement of financial position, additional information (in narrative form) that provides sufficient information to allow financial statement users to understand the quantitative disclosures and the information that the investor considered (both positive and negative) in reaching the conclusion that the impairment(s) are not other than temporary. The application of Step 2 shall provide insight into the investor's rationale for concluding that unrealized losses are not other-than-temporary impairments. The disclosures required may be aggregated by investment categories, but individually significant unrealized losses generally shall not be aggregated. This disclosure could include:
- (1) The nature of the investment(s)
 - (2) The cause(s) of the impairment(s)
 - (3) The number of investment positions that are in an unrealized loss position
 - (4) The severity and duration of the impairment(s)
 - (5) Other evidence considered by the investor in reaching its conclusion that the investment is not other-than-temporarily impaired, including, for example, industry analyst reports, sector credit ratings, volatility of the security's fair value, and/or any other information that the investor considers relevant.

18. For cost-method investments, an investor shall disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

- a. The aggregate carrying amount of all cost-method investments
- b. The aggregate carrying amount of cost-method investments that the investor did not evaluate for impairment
- c. The fact that the fair value of a cost-method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment, and
 - (1) The investor determined, in accordance with paragraphs 14 and 15 of Statement 107, that it is not practicable to estimate the fair value of the investment, or
 - (2) The investor is exempt from estimating fair value under FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*.

Effective Date and Transition

19. The guidance in this FSP shall be applied to reporting periods beginning after December 15, 2005. Earlier application is permitted.

Appendix A

EXAMPLE OF THE APPLICATION ON DISCLOSURES ABOUT INVESTMENTS IN AN UNREALIZED LOSS POSITION THAT ARE NOT OTHER-THAN-TEMPORARILY IMPAIRED

A1. The following table shows the gross unrealized losses and fair value of the Company’s investments with unrealized losses that are not deemed to be other-than-temporarily impaired (in millions), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 20X3. This example illustrates the application of paragraphs 17 and 18 and, in doing so, describes the investor’s rationale for not recognizing all unrealized losses presented in the table as other-than-temporary impairments. In the application of paragraph 17(b), the investor shall provide meaningful disclosure about individually significant unrealized losses. To facilitate the narrative disclosures and for simplicity, this example presents only the quantitative information as of the date of the latest statement of financial position. However, pursuant to paragraph 17, that information is required as of each date for which a statement of financial position is presented, except in the period of initial application of this FSP.

Description of Securities	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury obligations and direct obligations of U.S. government agencies	\$ 172	\$ 2	\$ 58	\$ 1	\$ 230	\$ 3
Federal agency mortgage-backed securities	367	5	18	1	385	6
Corporate bonds	150	7	0	0	150	7
Marketable equity securities	44	8	0	0	44	8
Investments in equity securities carried at cost	20	1	0	0	20	1
Total	\$ 753	\$23	\$ 76	\$ 2	\$ 829	\$ 25

A2. U.S. Treasury Obligations. The unrealized losses on the Company's investments in U.S. Treasury obligations and direct obligations of U.S. government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the Company has the ability and intent to hold those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 20X3.

A3. Federal Agency Mortgage-Backed Securities. The unrealized losses on the Company's investment in federal agency mortgage-backed securities were caused by interest rate increases. The Company purchased those investments at a discount relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company has the ability and intent to hold those investments until a recovery of fair value, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 20X3.

A4. Corporate Bonds. The Company's unrealized loss on investments in corporate bonds relates to a \$150 investment in Manufacturing Company's Series C Debentures. The unrealized loss was primarily caused by (a) a recent decrease in profitability and near-term profit forecasts by industry analysts resulting from intense competitive pricing pressure in the manufacturing industry and (b) a recent sector downgrade by several industry analysts. The contractual terms of those investments do not permit Manufacturing Company to settle the security at a price less than the amortized cost of the investment. While Manufacturing Company's credit rating has decreased from A to BBB (S&P), the Company currently does not believe it is probable that it will be unable to collect all amounts due according to the contractual terms of the investment. Therefore, it is expected that the debentures would not be settled at a price less than the amortized cost of the investment. Because the Company has the ability and intent to hold this investment

until a recovery of fair value, which may be maturity, it does not consider the investment in Manufacturing Company's debentures to be other-than-temporarily impaired at December 31, 20X3.

A5. Marketable Equity Securities. The Company's investments in marketable equity securities consist primarily of investments in common stock of companies in the consumer tools and appliances industry (\$17 of the total fair value and \$2 of the total unrealized losses in common stock investments) and the air courier industry (\$27 of the total fair value and \$6 of the total unrealized losses in common stock investments). Within the Company's portfolio of common stocks in the consumer tools and appliances industry (all of which are in an unrealized loss position) approximately 26 percent of the total fair value and 21 percent of the Company's total unrealized losses are in Company R. The remaining fair value and unrealized losses are distributed in six companies. The severity of the impairment (fair value is approximately 5 percent to 12 percent less than cost) and the duration of the impairment (less than 3 months) correlate with the weak 20X3 year-end sales experienced within the consumer tools and appliance industry, as reflected in lower customer transactions and lower-than-expected performance in traditional gift categories like hardware and power tools. The Company evaluated the near-term prospects of the issuer in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 20X3.

A6. The Company's portfolio of common stocks in the air courier industry consists of investments in 4 companies, 3 of which (or 78 percent of the total fair value of the investments in the air courier industry) are in an unrealized loss position. The air courier industry and the Company's investees are susceptible to changes in the U.S. economy and the industries of their customers. A substantial number of their principal customers are in the automotive, personal computer, electronics, telecommunications, and related industries, and their businesses have been adversely affected by the slowdown of the U.S.

economy, particularly during the second half of 20X3 when the Company's investments became impaired. In addition, the credit ratings of nearly all companies in the portfolio have decreased from A to BBB (S&P or equivalent designation). The severity of the impairments in relation to the carrying amounts of the individual investments (fair value is approximately 17 percent to 23 percent less than cost) is consistent with those market developments. The Company evaluated the near-term prospects of the issuers in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 20X3.

A7. Investments in Equity Securities Carried at Cost. The aggregate cost of the Company's cost-method investments totaled \$45 at December 31, 20X3. Investments with an aggregate cost of \$10 were not evaluated for impairment because (a) the Company did not estimate the fair value of those investments in accordance with paragraphs 14 and 15 of Statement 107 and (b) the Company did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of those investments. Of the remaining \$35 of investments, the Company estimated that the fair value exceeded the cost of investments (that is, the investments were not impaired) with an aggregate cost of \$14.

A8. The remaining \$21 of cost-method investments consists of 1 investment in a privately owned company in the consumer tools and appliance industry. That investment was evaluated for impairment because of an adverse change in the market condition of companies in the consumer tools and appliance industry. As a result of that evaluation, the Company identified an unrealized loss of \$1. The severity of the impairment (fair value is approximately 5 percent less than cost) and the duration of the impairment (less than 3 months) correlate with the weak 20X3 year-end sales experienced within the consumer tools and appliance industry, as reflected by lower customer transactions and lower-than-expected performance in traditional gift categories like hardware and power tools. Based on the Company's evaluation of the near-term prospects of the investee and

the Company's ability and intent to hold the investment for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider that investment to be other-than-temporarily impaired at December 31, 20X3.

Appendix B

AMENDMENTS TO EXISTING PRONOUNCEMENTS

B1. The following amendments to existing pronouncements are required to facilitate the appropriate reference and application in accordance with the scope of this FSP. [Additions are underscored.]

B2. FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, is amended as follows:

a. Footnote 4 to paragraph 16, as amended:

A decline in the value of a security that is other than temporary is also discussed in FSP FAS 115-1 and FAS 124-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,” AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, and in SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities*.

B3. FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*:

a. Paragraph 7:

Investments in equity securities with readily determinable fair values and all investments in debt securities shall be measured at fair value in the statement of financial position.^{3a}

^{3a} Some investors, primarily health care organizations, indicated that because Statement 115 requires business entities to report changes in fair value of available-for-sale securities in a separate category of equity and to report held-to-maturity securities at amortized cost, users would be unable to make meaningful comparisons when not-for-profit organizations and business entities are engaged in the same industry. This Statement allows an organization with those comparability concerns to report in a manner similar to business entities by identifying securities as available-for-sale or held-to-maturity and excluding the unrealized gains and losses on those securities from an operating measure within the statement of activities. Investors that report a “performance indicator” as defined in the AICPA Accounting and Audit Guide, *Health Care Organizations*, shall refer to FSP FAS 115-1 and FAS 124-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,” when determining impairment and evaluating whether the impairment is other than temporary.

B4. APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, is amended as follows:

a. Paragraph 6(a):

The cost method. An investor records an investment in the stock of an investee at cost, and recognizes as income dividends received that are distributed from net accumulated earnings of the investee since the date of acquisition by the investor. The net accumulated earnings of an investee subsequent to the date of investment are recognized by the investor only to the extent distributed by the investee as dividends. Dividends received in excess of earnings subsequent to the date of investment are considered a return of investment and are recorded as reductions of cost of the investment. A series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred which is other than temporary and should accordingly be recognized.^{3a}

^{3a} FSP FAS 115-1 and FAS 124-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,” discusses the methodology for determining impairment and evaluating whether the impairment is other than temporary.