

Letter of Comment No: 159
File Reference: EITF03-1A

October 29, 2004

Mr. Lawrence Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed FASB Staff Position No. EITF Issue 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"*

Dear Mr. Smith:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the proposed FASB Staff Position No. EITF Issue 03-1-a (the "Proposed FSP"), "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1."

While we believe that the FASB's efforts to address constituent concerns relative to the consensus reached in EITF Issue 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," are warranted, we also believe that those same concerns highlight broader conceptual issues that are beyond the scope of the matters addressed in the Proposed FSP and the original EITF Issue consensus.

Conceptual Impairment Model

A primary issue that creates many of these concerns is the conceptual justification for different impairment models for loan receivables as compared to debt securities. A loan receivable becomes impaired under FAS 114, "Accounting by Creditors for Impairment of a Loan," when it is probable that the creditor will be unable to collect the contractual interest and principal payments of that loan as scheduled in the loan agreement. Similar language is incorporated in paragraph 16 of FAS 115, "Accounting for Certain Investments in Debt and Equity Securities." However, FAS 115, by reference to SAB 59 and Question 46 of the FAS 115 Implementation Guide, goes beyond FAS 114 by requiring a company to have a positive intent to hold to recovery to avoid an other-than-temporary impairment. We find it difficult to reconcile, both conceptually and economically, why the factors to be considered for an impairment charge for a United States government debt security are more stringent than the factors for a third party loan receivable. For this reason, during the EITF Issue 03-1

deliberations, we supported a model that treats U.S. government and other high credit quality debt securities consistent with loan receivables. We acknowledge that achieving this conceptually and economically superior model would require amending existing FASB and SEC literature. We continue to believe, however, that a conceptually consistent model for similar economic instruments, such as loans and debt securities, is more appropriate than the current approach and we support the FASB pursuing such an objective.

Multiple Financial Instrument Models

Certain other constituent objections to the EITF consensus stem from the different attribute models for investment (asset) versus financing (liability) instruments. For many financial services companies, the ongoing use of historical cost basis accounting for financial (debt) obligations and fair value basis accounting for investments results in income statement volatility that does not reflect the economics of companies' operations. We encourage the FASB to continue to pursue reporting all financial instruments at fair value in order to eliminate such financial reporting anomalies

One Time Transition

Adoption of EITF 03-1 should be considered one of the rare instances when a company is allowed to transfer securities to the trading category under paragraph 15 of FAS 115. The change in a company's practices resulting from the implementation of additional guidance on an existing accounting pronouncement is unusual. If such a transfer to trading is not allowed, because of designation decisions made prior to the consensus, companies that are unable to assert positive intent and ability to hold to recovery will be required to use lower of cost or market accounting, recognizing unrealized losses in the income statement without unrealized gains being treated similarly. We recommend that the Proposed FSP explicitly state that a one-time transfer to trading from the available for sale category is permitted in the period of adoption of EITF 03-1. Another reason for allowing a one time transfer to trading is the interplay between a company's assertions about its intent to hold to recovery under EITF 03-1 and its assertions needed under ARB 43, Chapter 3, paragraphs 4 and 6 to classify those securities as current assets when the securities are available to fund current operations. Given the requirement under EITF 03-1 to assert intent to hold to recovery, which may mean until maturity, companies may not be able to classify available for sale securities as current. However, if companies classify these securities as "trading," such potential for conflict is eliminated.

EITF 03-1 paragraph 10 and 16 Impairment Models

If the Board chooses not to amend existing guidance to achieve consistent impairment models as suggested above, we recommend that it clarify the circumstances in which the impairment models in EITF 03-1 would apply to investments in debt securities. We believe investments in debt securities have certain characteristics that are consistent with instruments to which two different impairment models are applied, the modified receivables model (paragraph 16 of EITF 03-1) and the marketable equity securities model (paragraphs 10-15 of EITF 03-1). We

believe that if a company determines that the modified receivables model (paragraph 16) should no longer be followed (i.e., the company does not assert an intent to hold to maturity if necessary for recovery), it should apply the marketable equity securities model in paragraphs 10 to 15, including evaluating evidence of a possible forecasted recovery of fair value within a reasonable time. We recommend that the Board clarify this approach through the use of a flowchart or diagram.

Detailed Responses

Our responses to the issues in the Requests for Comments and the questions in the Proposed FSP are provided below in the context that existing literature will not be amended to address the concerns above.

Issue 1: Do you believe that financial statement preparers and auditors will be able to apply the notion of “minor impairment” without any additional guidance from the FASB? If not, do you believe that the Board should specify a numerical rule or threshold and, if so, what would that rule or threshold be?

We agree with the Board that minor impairments should be considered temporary without further analysis because normal interest rate and/or sector spread volatility may be sufficient to allow for a reasonably possible forecasted recovery of fair value. We believe, however, that the introduction of a new term, “minor,” may result in inconsistent application. We suggest using the words contained in EITF Issue 99-20 and FAS 140 paragraph 14. That is, within the context of the Proposed FSP, when a security’s fair value is at least “substantially all” of the investor’s cost, any impairment is considered temporary.

We agree with the Board’s decision not to use a quantitative threshold in defining “minor” (or in defining “substantially all,” if our suggested wording is accepted). Providing such a “bright line” is inconsistent with the FASB’s and our stated goals to achieve principles-based standards.

Issue 2: Do you support the Board’s conclusion to limit the notion of “minor impairments” to debt securities analyzed for impairment under paragraph 16 that are impaired because of interest rate and/or sector spread increases? If not, why?

The concept of normal volatility causing temporary changes in value is equally valid to equity securities as it is for debt securities. We, therefore, support extending the concept of “minor impairments” or our concept of “substantially all of an investor’s cost” to investments analyzed for impairment under paragraphs 10-15 of EITF 03-1.

Question 1: At what unit of account should an investor assert its ability and intent to hold to a forecasted recovery?

We agree with the proposed Response.

Question 2: Although Issue 03-1 states that an investment is impaired if the fair value of the investment is less than its cost, paragraph 16 does not refer to the severity of the impairment. Is there a level of impairment that can be considered temporary that would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery?

Please refer to our comments under the heading *EITF 03-1 paragraph 10 and 16 Impairment Models* and our response in Issue 1 above.

Question 3(a): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, when is the impairment considered other than temporary?

We agree with the proposed Response that an impairment should be considered other-than-temporary at the time a company changes its intent regarding an individual security and can no longer assert its ability and intent to hold that security for a reasonable period of time sufficient for a forecasted recovery of fair value. In addition, we believe that EITF Topic D-44 would require even a minor impairment to be recognized if a decision to sell has been made.

However, we suggest the wording in the first sentence of paragraph 6 of the Proposed FSP be changed to clarify this concept and our summary comment on the paragraphs 10-15 and 16 models as follows:

"An impairment is considered other than temporary when the investor is unable to assert its ability and intent to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the cost of the investment."

Question 3(b): If an interest-rate-impaired and/or sector-spread-impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, are there circumstances for such a change in ability or intent that would not necessarily call into question the investor's ability or intent to hold other securities to recovery?

We agree that changes in a company's intent to hold a security in circumstances discussed in paragraphs 8 and 11 of FAS 115 and the additional circumstances in paragraph 7 of the proposed Response should not call into question the investor's intent to hold other securities to recovery.

We recommend, however, that the Board consider providing additional guidance to assist companies in applying the term "unexpected," which is used in paragraph 7 of the proposed Response. We believe there could be varying interpretations of that term, which may lead to inconsistent application of this guidance. We are not asking the Board to define "unexpected." We are asking the Board to explain its views on how to apply the term "unexpected" within



the context of how the market establishes a forward interest rate curve. Some practitioners believe that the forward yield curve is the best indicator as of a point in time of expected future interest rates and that deviations between those expectations and what actually occurs must be “unexpected.” Other practitioners (including PwC) believe that there is a range of reasonable expectations of changes in interest rates, using historical or other means of estimating volatility, and that the probable outcomes within this reasonable range generate the forward yield curve. Under this latter view, “unexpected” changes would be outcomes outside the range of normal fluctuations. We recommend that the Response articulate the Board’s underlying thinking and perhaps provide examples for illustration purposes.

We appreciate the opportunity to express our views on the Proposed FSP. If you have any questions regarding our comments, please contact Donald Doran (973-236-7214) or Woody Wallace (646-471-2850).

Sincerely,

PricewaterhouseCoopers LLP