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October 27, 2004

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

Proposed FASB Staff Position 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:

We agree that additional implementation guidance for all securities analyzed for impairment in EITF Issue No. 03-1 (EITF 03-1) is needed. As such, we support the staff's desire to broaden the guidance from that contained in draft FSP EITF Issue 03-1-a (the draft FSP) to apply the guidance in paragraphs 10-15 of EITF 03-1 to paragraph 16 securities. Our specific comments on the draft FSP are provided below.

Application of Paragraph 11-15 Guidance to Paragraph 16 Securities

We believe that the application of EITF 03-1 to paragraph 16 securities would be improved if those securities were explicitly evaluated using the model or framework provided in paragraphs 11-15. As such, assessing whether a decline in fair value for a paragraph 16 instrument is other-than-temporary should include a consideration of the severity and duration of the impairment. This would permit preparers to establish a consistent impairment evaluation approach for evaluating impairments for all instruments within the scope of EITF 03-1.

The concepts of severity and duration are consistent with the SEC's guidance in SEC Staff Accounting Bulletin No. 59 Noncurrent Marketable Equity Securities and SAB Topic 5:M Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities (SAB Topic 5:M). We believe these concepts are applicable both in situations



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where a decline in fair value is caused by credit-related factors, or as a consequence of interest rate and/or sector spread movements. Therefore, we do not believe that there should be a separate impairment model for interest-rate-impaired or sector-spread-impaired securities as suggested in paragraph 3 of the draft FSP.

Minor Impairments

We agree with the view that minor impairments may be considered temporary because normal interest rate and sector spread volatility may result in a recovery of a minor impairment. However, we do not believe that the notion of a "minor" impairment needs to be included in the FSP because "severity" is already discussed in SAB Topic 5:M and in paragraphs 11 and 13 of EITF 03-1 and, as noted above, we believe the guidance in paragraphs 11 through 15 of EITF 03-1 should be applied to paragraph 16 securities as well. The severity concept already captures the analysis that would be needed to assess a "minor" impairment making a separate notion of minor unnecessary. Therefore, its inclusion would create confusion as some might interpret the assessment of "minor" as being in addition to the analysis of severity.

Consistent with the Board's move to more objectives-oriented standards, we agree that the FSP should not include a "bright-line" numerical threshold for making the determination of whether an impairment of securities is other-than-temporary. However, if the Board determines that the FSP should incorporate the notion of a minor impairment, the FSP should provide guidance as to the factors that should be considered in assessing whether an impairment of a security is minor.

FSP Questions:

Question 1 - Unit of Account

The draft FSP indicates that an assertion of ability and intent should be made at the *individual security* level. We agree with that view; however, it is unclear whether this approach is intended to mean individual instruments of the same type of security (e.g., each individual share when an investor holds 100 identical shares of Company X stock or each CUSIP of identical bonds of Company Y) or all of a type of a security (e.g., all 100 Company X shares or all Company Y bonds held). We understand it to mean the former.

Question 2 - Level of Impairment

As described above, we believe that the severity and duration of the decline in fair value should be considered in the evaluation of other-than-temporary impairment for all



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securities within the scope of EITF 03-1. Applying the same framework to all securities within the scope of EITF 03-1 for evaluating other-than-temporary impairments would make the evaluation more consistent with SAB Topic 5:M.

Question 3(a) - Security Expected to be Sold

Generally we agree with the guidance in paragraph 6 of the draft FSP. We suggest the following alternate wording for the last sentence of the paragraph to clarify the intended meaning: "However, an investor should recognize an impairment loss no later than when the impairment has become other-than-temporary, even if a decision to sell has not been made."

Question 3(b) - Circumstances that do not call into question the investor's ability or intent to hold securities to recovery

We believe that the word <u>and</u> at the end of paragraph 7(b) should be <u>or</u>. Otherwise, the language implies that all three circumstances noted in paragraph 7 must be present in order to not call into question the holder's ability and intent to hold the securities to forecasted recovery. We believe that it is the staff's intent that the existence of any of these circumstances would be sufficient not to cause a "taint" of the remaining securities.

The circumstance noted in paragraph 7(b) is that there are "unexpected and significant increases in interest rates and/or sector spread". Because the Federal Reserve generally signals increases in interest rates before it acts, we believe that an increase in interest rates, at least in the United States, would rarely, if ever, qualify for this exception, as the upward adjustment of interest rates by the Federal Reserve can be reasonably expected and predicted. We believe that the 7(b) circumstance should not require that the increase be "unexpected" as this would greatly limit the usefulness of this exception.

It would also be useful for the FSP to address whether a "de minimis" volume noted in paragraph 7(c) should be viewed in terms of dollar amounts or in terms of quantity/number of positions sold or both.

One-Time Realignment of Investment Portfolios

Entities may find it necessary to reclassify investments from available-for-sale to the trading category upon initial application of EITF 03-1. We believe that a one-time realignment of investment portfolios that permits this one-way transfer should be allowed without violating the presumption in paragraph 15 of FASB Statement No. 115,



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Accounting for Certain Investments in Debt and Equity Securities, that transfers into the trading category should be rare.

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If you have questions about our comments or wish to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or Michael Pierce at (212) 909-5663.

Sincerely,

KPMG LLP