

Issue No. 03-1

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

Dates Discussed: September 11–12, 2002; November 21, 2002 (discussed as part of Issue 02-14); January 23, 2003; March 20, 2003; May 15, 2003; July 31, 2003; November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

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

FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

AICPA Statement of Position No. 03-3, *Accounting for Loans or Certain Debt Securities Acquired in a Transfer*

AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*

AICPA Accounting and Auditing Guide, *Health Care Organizations*

SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities*

Issue

1. The issue is to determine the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under

Statement 115 (including individual securities and investments in mutual funds), and investments accounted for under the cost method or the equity method.

Prior EITF Discussion

2. EITF Issue No. 02-14, "Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means," is a scope issue related to Opinion 18. In responding to that Issue, the FASB staff developed a view that recommended that the Task Force define *other-than-temporary* impairment and provide additional guidance on how other-than-temporary impairment should be applied to certain investments accounted for by the cost method under Opinion 18. At the September 11–12, 2002 EITF meeting, the Task Force requested that the FASB staff develop views regarding the meaning of other-than-temporary impairment and its application to certain investments carried at cost.

3. At the November 21, 2002 EITF meeting, the Task Force discussed the meaning of other-than-temporary impairment and its application to certain investments carried at cost. The Task Force requested that the FASB staff consider other impairment models within the framework of generally accepted accounting principles when developing its views. The Task Force also requested that the scope of the impairment issue be expanded to include equity method investments and investments subject to Statement 115 and that the issue be addressed by the Task Force separately from Issue 02-14.

4. At the January 23, 2003 EITF meeting, the Task Force noted that several complex issues surround the application of other-than-temporary impairment. In light of those complex issues, the Task Force requested that a working group be established to develop an approach for assessing other-than-temporary impairment that would be appropriate for different types of investments.

5. At the March 20, 2003 EITF meeting, the Task Force discussed proposed guidance for assessing other-than-temporary impairment that was recommended by the Working Group. That proposed guidance would apply to investments accounted for under the cost method or the equity method, investments classified as either available-for-sale or held-to-maturity under Statement 115 (including individual securities and mutual funds), and investments accounted for under Statement 124. It would not apply to investments within the scope of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." The proposed guidance includes the following:

- Step 1: Determine whether an investment is impaired
- Step 2: Determine whether an impairment is other than temporary
- Step 3: Recognize an impairment loss equal to the difference between the investment's carrying amount and its fair value (measured as of the balance sheet date).

6. Step 1 of the proposed guidance generally states that an investment is considered impaired if its fair value is less than its amortized cost basis (hereinafter referred to as its carrying amount).

7. Step 2 of the proposed guidance includes the following underlying principle for determining whether an impairment is other than temporary: an impairment should be deemed other than temporary unless positive evidence indicating that an investment's carrying amount is recoverable within a reasonable period of time outweighs negative evidence to the contrary. Under the proposed guidance, the longer the investment's fair value is below its carrying amount, the more unlikely it becomes that sufficient objective and verifiable positive evidence would be available to support the recoverability of the investment's carrying value to overcome the extent of the negative evidence, except for certain investments with noncontingent contractual future cash flows. In attempting to clarify that notion, the model proposed at the March 20, 2003 EITF meeting included a rebuttable presumption that an impairment would be considered other than temporary after one year.

8. The Task Force generally supported the proposed guidance with respect to its application to equity securities but asked that the Working Group further refine some of the specific guidance within each of the steps of the impairment model. The Task Force also requested that the Working Group further explore the application of Step 2 of the proposed guidance to certain debt securities, including the impact of an investor's ability and/or intent to hold an investment when it is not probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security that was not impaired at acquisition and the decline in its fair value is due only to interest rate fluctuations.

9. The Task Force also requested that the Working Group further consider the accounting for the investment after an impairment is recognized under Step 3 of the proposed model, specifically focusing on investments accounted for under the equity method.

10. At the May 15, 2003 EITF meeting, the Task Force discussed additional Working Group recommendations regarding the refinement of the proposed guidance for assessing other-than-temporary impairment. The Task Force expressed concern over the applicability and feasibility of a single impairment model for all types of investments. Consequently, the Task Force directed the FASB staff to consider whether the characteristics of different types of investments (for example, Statement 115 available-for-sale equity securities, Statement 115 available-for-sale and held-to-maturity debt securities, and investments subject to Opinion 18) require different models for evaluating whether or when an impairment is considered other than temporary.

11. At the July 31, 2003 EITF meeting, the Task Force discussed separate impairment models proposed by the FASB staff for each of the following categories of investments: (a) Statement 115 and Statement 124 equity securities, (b) Statement 115 and Statement 124 debt securities, (c) cost method investments (that is, equity securities that are not subject to the scope of Statement 115 and not accounted for under the equity method), and (d) equity method investments. Those models were generally consistent with the three-step approach proposed at the March meeting with the following exceptions:

- Under the models for cost method investments and equity method investments without a readily determinable fair value, Step 1 was modified to include certain triggers for when an impairment test should be performed

- Under each of the models, Step 2 was tailored to the nature of the investment. For example, the proposed model for debt securities includes a consideration of the probability of collection of contractual cash flows.

12. The Task Force generally supported the underlying principles in each of the proposed impairment models for equity securities, debt securities, and cost method investments. However, the Task Force suggested further refinement to those models to, among other things:

- a. Eliminate the rebuttable presumption that an impairment is considered other than temporary after a one-year period of impairment
- b. Further emphasize the notion that the weight of evidence indicating an other-than-temporary impairment increases as the length of time that an investment's fair value is below its carrying amount increases and that, therefore, greater positive evidence will be required to conclude that an impairment is temporary as the duration of impairment increases
- c. Require the investor to disclose in its financial statements information about unrealized holding losses that have not been recognized as other-than-temporary impairments. Some Task Force members suggested disclosures about the aging of those unrealized losses, and some suggested disclosures about the evidence supporting the conclusion that the investments to which those losses relate are not other-than-temporarily impaired.

13. In addition, the Task Force suggested that the proposed impairment model for debt securities be further refined to clarify the intent and operation of the considerations in the proposed model for determining other-than-temporary impairment for investments in debt securities with noncontingent contractual cash flows. In particular, the Task Force agreed on the general principle that impairments due to deterioration in credit that result in a conclusion that noncollection is probable should be considered other than temporary. Other declines in fair value (for example, due to interest rate changes, sector credit rating changes, or company-specific rating changes that do not result in a conclusion that noncollection of contractual principal and interest is probable) may not result in a conclusion that an other-than-temporary impairment has occurred, subject to the other considerations in the proposed model. Therefore, the Task Force asked the Working Group to further refine Step 2 of the model for debt securities to differentiate those securities for which noncollection is probable from those securities for which collection is probable but which, based on other considerations, may be considered other-than-temporarily impaired. The Task Force also requested that the Working Group develop further guidance for determining what constitutes "noncontingent contractual cash flows."

14. For cost method investments, because fair value is not readily determinable, the Task Force generally agreed that investments should be tested for impairment annually, or more frequently if certain indicators are present, rather than at each reporting date. However, certain Task Force members expressed concerns that because information necessary to estimate the fair value of a cost method investment may not be readily available to the investor, even limiting the impairment test to an annual evaluation may not be practical. Therefore, the FASB staff will explore an alternative model that would require an impairment test only when certain indicators are present.

15. The Task Force agreed to consider further development of an impairment model for the fourth category of investments discussed—equity method investments—after the impairment models for other types of investments have been further refined.

16. In addition, the Task Force requested that, as the other models are refined, the FASB staff consider further the implications of including within or excluding from the scope of this Issue (a) investments of not-for-profit organizations and (b) beneficial interests in transferred financial assets subject to the scope of Issue 99-20. Some Task Force members also requested clarification of the classification, for purposes of this Issue, of investments in mutual funds that invest in debt securities and suggested that the classification follow the guidance in Question 5 of the Special Report on Statement 115, which indicates that an investor should not "look through" the form of an investment to the underlying investments of the investment vehicle.

17. At the November 12–13, 2003 EITF meeting, the Task Force discussed several of the recommendations set forth by the Working Group on the proposed models for evaluating impairment of equity securities and debt securities but was not asked to reach a consensus. However, the Task Force expressed support in general for the underlying principles and asked the FASB staff to consider the following refinements to certain of the elements in those models:

- a. Recombine the separate models for (1) equity securities, (2) debt securities, and (3) cost method investments into a single model with unique steps or analyses where appropriate (for example, the trigger-based approach in Step 1 of the cost method model or the special guidance on subsequent accounting in the debt securities model).
- b. Consider whether the other-than-temporary impairment considerations in this Issue that are incremental to the impairment considerations in Issue 99-20 should be incorporated directly into Issue 99-20.
- c. Reconcile the principle of considering the relative weight of evidence in its entirety with the guidance that suggests a recent but precipitous decline in market value or a slight but protracted decline in market value could individually lead to a conclusion that an impairment is other than temporary. Some Task Force members expressed concern that the guidance regarding a recent but precipitous decline or a slight but protracted decline in market value, as currently presented, takes precedence over the entire evidence-based analysis.
- d. In developing an evidence-based judgment about a forecasted market price recovery, the model should emphasize that the investor must consider and give appropriate and unbiased weighting to all reasonably available third-party information (as opposed to reliance on selected information).
- e. For debt securities that cannot be contractually prepaid or otherwise contractually settled in such a way that the investor would not recover substantially all of its amortized cost, clarify whether collateral should be considered a guarantee or other credit enhancement for

purposes of determining whether it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt security.

- f. Eliminate the reference to "a reasonable period of time" from the model for debt securities that cannot be contractually prepaid or otherwise contractually settled in such a way that the investor would not recover substantially all of its amortized cost. The Task Force believes that the "reasonable period of time" provision is irrelevant because the investor must assert its ability and intent to hold the investment until the earlier of (1) maturity or (2) a market price recovery.

18. Although the Task Force requested further revisions to the underlying impairment models, at the November 12–13, 2003 EITF meeting, the Task Force reached a consensus that certain quantitative and qualitative disclosures should be required for debt and marketable equity securities classified as available-for-sale or held-to-maturity under Statements 115 and 124 that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The consensus on quantitative and qualitative disclosures was effective for fiscal years ending after December 15, 2003. The Board ratified the consensus reached by the Task Force at its November 25, 2003 meeting.

Current EITF Discussion

19. At the March 17–18, 2004 EITF meeting, the Task Force reached a consensus that the guidance in the draft abstract, included as Appendix 03-1A, should be used to determine whether an investment within the scope of this Issue is other-than-temporarily impaired.

20. The Task Force discussed whether an investor with cost method investments, as defined in the attached draft abstract, should estimate the fair value of those investments annually for purposes of applying Step 1 of the impairment model, or whether the investor should estimate fair value when an impairment indicator is present. The Task Force reached a consensus that the investor should estimate the fair value of a cost method investment when an impairment indicator is present. A list of potential impairment indicators is included in the attached draft abstract. The Task Force also noted that those indicators are relevant only for cost method investments for which the investor is not otherwise required to estimate the fair value on an annual basis (for example, under the disclosure requirements of Statement 107). The Task Force also discussed disclosure requirements for cost method investments and reached a consensus that the investor should provide certain quantitative and qualitative disclosures for cost method investments that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized and certain quantitative information about cost method investments not tested for impairment under Step 1 of the impairment model.

21. The Task Force also discussed certain refinements to the draft abstract, including (a) eliminating the requirement to disclose the amount of interest income attributable to amortization of the incremental discount resulting from an other-than-temporary impairment of a debt security, and (b) referring to SOP 03-3 for the accounting for a debt security subsequent to an other-than-temporary impairment. These refinements are reflected in the draft abstract.

22. The Task Force also reached a consensus that the following should be added to the Status section of Issue 99-20 in *EITF Abstracts*:

At the March 17-18, 2004 EITF meeting, the Task Force reached a consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." Issue 03-1 provides guidance for determining when an investment is other-than-temporarily impaired that is incremental to the considerations in this Issue—specifically, whether an investor has the ability and intent to hold an investment until recovery. In addition, Issue 03-1 contains disclosure requirements that provide useful information about impairments that have not been recognized as other than temporary for investments within the scope of this Issue. Therefore, in instances in which an investor determines that an investment with a fair value less than cost is not other-than-temporarily impaired under the guidance in this Issue, the investor should also assess its ability and intent to hold the investment as described in paragraph 12 [of the draft abstract] of Issue 03-1. In addition, the investor should disclose the information required by paragraph 21 of Issue 03-1 for investments with unrealized losses that have not been recognized as other-than-temporary impairments.

Transition

23. The guidance for evaluating whether an investment is other-than-temporarily impaired should be applied in other-than-temporary impairment evaluations made in reporting periods beginning after June 15, 2004. The disclosures are effective in annual financial statements for fiscal years ending after December 15, 2003, for investments accounted for under Statements 115 and 124. For all other investments within the scope of this Issue, the disclosures are effective in annual financial statements for fiscal years ending after June 15, 2004. The additional disclosures for cost method investments are effective for fiscal years ending after June 15, 2004. Comparative information for periods prior to initial application is not required.

Board Ratification

24. At its March 31, 2004 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

25. At the March 17–18, 2004 EITF meeting, the Task Force decided to discontinue discussion of an impairment model for investments subject to the equity method of accounting. No further EITF discussion is planned. The SEC Observer stated that registrants should continue to rigorously assess equity method investments for impairment and indicated that the SEC staff will continue to object to inappropriate impairment analyses for such investments, for example a Statement 144 undiscounted cash flow approach.

EITF Abstracts (DRAFT¹)

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AICPA Statement of Position No. 03-3, *Accounting for Loans or Certain Debt Securities Acquired in a Transfer*

¹ This draft abstract was prepared to facilitate discussion of the guidance on which the Task Force reached its consensus and contains all substantive aspects of the consensus. The final abstract, which will be included in the next update for *EITF Abstracts*, may contain nonsubstantive editorial revisions.

AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*

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ISSUE

1. The impairment methodology for various types of investments accounted for in accordance with the provisions of Opinion 18 and Statement 115 is predicated on the notion of other than temporary. Some believe that the authoritative literature discussing the notion of other than temporary is ambiguous and has led to inconsistent application.
2. While investments accounted for in accordance with Opinion 18 and Statement 115 share certain similarities, they are also different in many respects. In spite of such differences, the Task Force believes a common approach to evaluating other-than-temporary impairment to all such investments would reduce that ambiguity and inconsistent application.
3. The issue is to determine the meaning of other-than-temporary impairment and its application to debt and equity securities within the scope of Statement 115, certain debt and equity securities within the scope of Statement 124, and equity securities that are not subject to the scope of Statement 115 and not accounted for under the equity method of accounting.

EITF DISCUSSION

4. For investments that meet the scope of this Issue, the Task Force reached a consensus that the application guidance in paragraphs 6-20 should be used to determine when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The guidance 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. A flowchart summarizing the application guidance is included in Exhibit 03-1A, examples illustrating the application guidance are included in Exhibit 03-1B, and an example of disclosures about unrealized losses that have not been recognized is included in Exhibit 03-1C.

Scope²

5. This impairment model is applicable for investments in:

²For investments accounted for under Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets," the investor should first apply the provisions of that Issue. If the security is not other-than-temporarily impaired under Issue 99-20, the investor should then determine whether the investment is impaired under the guidance in paragraph 12 of this Issue. In addition, an investor should provide the disclosures described in paragraph 21 of this Issue for unrealized losses that have not been recognized as other than temporary under Issue 99-20 or the incremental guidance in this Issue.

- a. Debt and equity securities that are within the scope of Statement 115^{3,4,5}
- 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 by the health care Guide
- c. Equity securities that are not subject to the scope of Statement 115 and not accounted for under the equity method under Opinion 18 and related interpretations (hereinafter referred to as "cost method investments").

Application Guidance

Step 1: Determine Whether an Investment Is Impaired

6. An investment is impaired if the fair value of the investment is less than its cost.⁶ Except as provided in paragraph 8, the investor should assess whether an investment is impaired for each reporting period.⁷

7. For investments other than cost method investments (refer to paragraph 5(c)), if the fair value of the investment is less than its cost, proceed to Step 2.

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

- a. If an investor has estimated the fair value of a cost method investment (for example, for Statement 107 disclosure), that estimate should be used to determine if the investment is impaired for the reporting periods in which the investor estimates 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,⁸ the investor should 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:

³ As indicated in paragraph 127 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 model would apply to all equity securities held by insurance companies.

⁴ Investors should 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 in debt securities would be assessed for impairment as an equity security under this Issue.

⁵ Some investments may require bifurcation and separate accounting for the host instrument and embedded derivative if certain criteria are met under paragraph 12 of Statement 133. The bifurcated host instrument would be evaluated for other-than-temporary impairment in accordance with this proposed guidance if the bifurcated host instrument meets the scope of this Issue.

⁶ *Cost* includes adjustments made to the cost basis of an investment for accretion, amortization, previous other-than-temporary impairments, foreign exchange, and hedging.

⁷ For entities that issue interim financial statements, each interim period is a reporting period.

⁸ For 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 only requires disclosure 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 Statement 126.

- A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
- A significant adverse change in the regulatory, economic, or technological environment of the investee
- A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
- 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
- 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.

In addition, if an investment was tested for impairment under Step 2 and the investor concluded that the investment was not other than temporarily impaired, the investor should continue to evaluate whether the investment is impaired (that is, should 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.

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

Step 2: Evaluate Whether an Impairment Is Other Than Temporary⁹

10. For equity securities (including cost method investments) and debt securities that can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost (refer to paragraph 16 for all other debt securities), an impairment should be deemed other than temporary unless:

- a. The investor has the 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, and
- b. Evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary.

11. The investor should make an evidence-based judgment about a recovery of fair value up to (or beyond) the cost of the investment by considering the severity and duration of the impairment in relation to the forecasted recovery of fair value.

12. *Investor's Ability and Intent.* An impairment should be deemed other than temporary unless the investor has the 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. The investor should consider whether its cash or working capital requirements and contractual or regulatory obligations indicate that the investment may need to be sold before the forecasted

⁹ *Other than temporary* does not mean permanent.

recovery of fair value occurs. In addition, in assessing its ability 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, the FASB staff observes that the investor should consider the *issuer's* ability to settle the security (for example, pursuant to a call provision) during the forecasted recovery period. Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent.

13. *Severity of the Impairment.* To evaluate the severity of the impairment, the investor should assess (a) the extent to which fair value is below cost and (b) the nature of the event (or events) that gave rise to the impairment. An other-than-temporary impairment may occur in a very short period of time after the initial investment or establishment of a new cost basis if, based on all available evidence, the cost of the investment is not recoverable within a reasonable period of time. As the severity of an impairment increases, greater evidence about a forecasted recovery of fair value will be required to conclude that an impairment is not other than temporary.

14. *Duration of the Impairment.* Duration refers to the period of time that a security has been impaired. As the duration of the impairment increases, greater evidence about a forecasted recovery of fair value up to (or beyond) the cost of the investment will be required to conclude that an impairment is not other than temporary.

15. *Forecasted Recovery of Fair Value.* The investor should develop an evidence-based judgment about a forecasted recovery of fair value. There are practical limitations on the period of time an investor can incorporate into its forecasted recovery of fair value, notwithstanding its ability or intent to hold an investment for an indefinite future period. As the forecasted recovery period lengthens, the uncertainties inherent in the investor's estimate increase, which impacts the reliability of that estimate. Therefore, greater evidence about a forecasted recovery of fair value will be required to conclude that an impairment is not other than temporary the further the expected recovery of fair value is from the point of the initial impairment. The investor's evidence-based judgment should give an appropriate and unbiased weighting to all reasonably available information, such as:

- The fair value of the investment after the balance sheet date but before the financial statements are issued¹⁰
- The regulatory, economic, or technological environment of the investee
- The general market condition of either the geographic area or the industry in which the investee operates
- Forecasts about the investee's financial performance and near-term prospects, such as earnings trends, dividend payments, asset quality, and analysts' or industry specialists' forecasts.

16. For debt securities that are not within the scope of paragraph 10, an impairment should be deemed other than temporary if (a) the investor does not have the ability and intent to hold an investment until a forecasted recovery of fair value up to (or beyond) the cost of the investment, which in certain cases may mean until maturity, or (b) it is probable that the investor will be

¹⁰ The investor should consider the guidance in Topic No. D-86, "Issuance of Financial Statements," for determining when financial statements are considered to have been issued.

unable to collect all amounts due according to the contractual terms of the debt security. In making the determination about collectibility, the investor should consider all information available, including evidence from rating agencies, about fair value fluctuations due to factors other than interest rates. Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent.

17. The investor should consider a guarantee or other credit enhancement in determining whether it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt security only if (a) the guarantee or other credit enhancement provides for payments to be made (or assets transferred) solely to reimburse the investor for failure of the investee to satisfy its required payment obligations, and (b) the guarantee or other credit enhancement is contractually included in the terms of the purchased debt security.¹¹ Similarly, an investor should not combine separate contracts (the debt security and the guarantee or other credit enhancement) for purposes of determining whether a debt security can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost.

18. If the investor determines that an impaired cost method investment is not other-than-temporarily impaired, the investor should continue to estimate the fair value of the investment each reporting period and provide an evidence-based judgment supporting the conclusion that the investment is not other-than-temporarily impaired until the investment is no longer impaired (due to either a recovery of fair value up to or beyond the cost of the investment or the recognition of an other-than-temporary impairment).

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

19. If it is determined in Step 2 that the impairment is other than temporary, then an impairment loss should be recognized in earnings equal to the 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 fair value of the investment would then become the new cost basis of the investment and should not be adjusted for subsequent recoveries in fair value.

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

20. In periods subsequent to the recognition of an other-than-temporary impairment loss, the investor should apply the provisions of SOP 03-3 in determining the amount and timing of income recognition.

Disclosures

21. For all investments in an unrealized loss position for which other-than-temporary impairments have not been recognized, the investor should disclose the following in its annual financial statements:

¹¹ Collateral is one form of a guarantee or other credit enhancement, and should be considered in the impairment evaluation of a debt security if conditions (a) and (b) of paragraph 17 are met.

- 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 (refer to paragraph 5(b)) and cost method investments—in tabular form:
 - (1) The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
 - (2) The aggregate related fair value of investments with unrealized losses.

The disclosures in (1) and (2) above should 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.¹²

- 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 impairments are not other than temporary.¹³ 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.

22. For cost method investments, the investor should 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, and
- 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

¹² 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 enterprises 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.

¹³ The application of paragraph 21(b) should provide insight into the investor's rationale for concluding that significant unrealized losses are not other-than-temporary impairments. Those disclosures may be aggregated by investment categories, but individually significant unrealized losses generally should not be aggregated.

- (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 Statement 126.

Transition

23. The recognition and measurement guidance in paragraphs 6-20 of this Issue should be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. For investments accounted for under Statement 115 and for investments accounted for under Statement 124 that are within the scope of this Issue (refer to paragraph 5(b)), the disclosure requirements in paragraph 21 of this Issue are effective for annual financial statements for fiscal years ending after December 15, 2003. For all other investments within the scope of this Issue, the disclosure requirements in paragraph 21 are effective for annual financial statements for fiscal years ending after June 15, 2004. The disclosure requirements for cost method investments in paragraph 22 are effective for annual financial statements for fiscal years ending after June 15, 2004. Comparative information for periods prior to initial application is not required.

Board Ratification

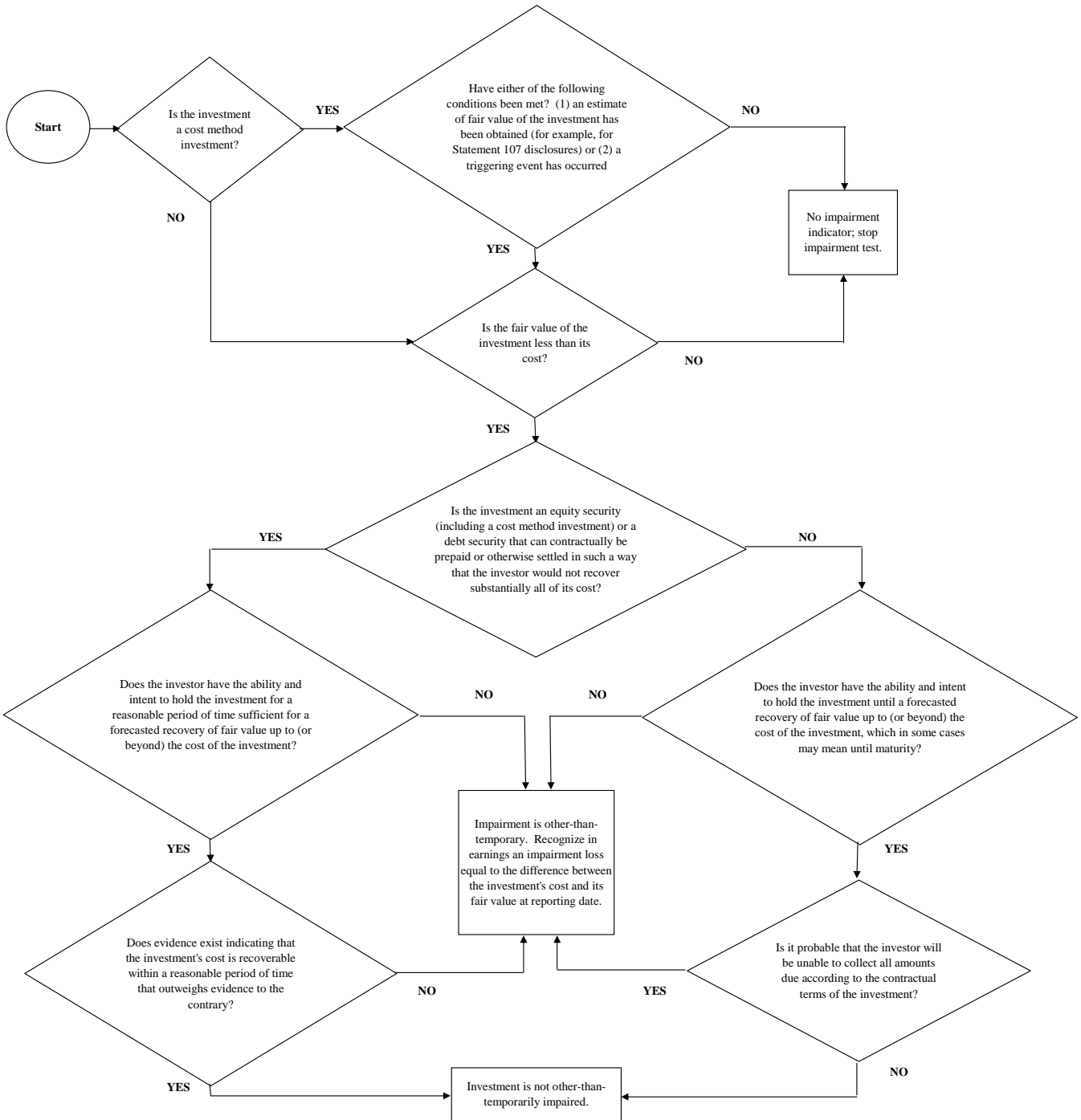
24. At its November 25, 2003 meeting, the Board ratified the consensus reached by the Task Force on the disclosures described in paragraph 21 for investments accounted for under Statement 115 and for investments accounted for under Statement 124 that are within the scope of this Issue (refer to paragraph 5(b)). At its March 31, 2004 meeting, the Board ratified the consensus reached by the Task Force on (a) the application guidance described in paragraphs 6-20, (b) the applicability of the disclosures in paragraph 21 to all other investments within the scope of this Issue, (c) the disclosures described in paragraph 22, and (d) the transition and effective date guidance described in paragraph 23.

STATUS

25. At the March 17-18, 2004 EITF meeting, the Task Force decided to discontinue discussion of an impairment model for investments subject to the equity method of accounting. No further EITF discussion is planned. The SEC Observer stated that registrants should continue to rigorously assess equity method investments for impairment and indicated that the SEC staff will continue to object to inappropriate impairment analyses for such investments, for example a Statement 144 undiscounted cash flow approach.

Exhibit 03-1A

DETERMINING WHETHER AN IMPAIRMENT IS OTHER THAN TEMPORARY¹⁴



¹⁴ This diagram represents an overview of the provisions of this Issue and should be reviewed in conjunction with the entire consensus.

Exhibit 03-1B

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON THE MODEL TO BE USED TO DETERMINE WHEN AN IMPAIRMENT IS OTHER THAN TEMPORARY

The following examples illustrate the application of several concepts included in the model, including:

- The determination of whether evidence indicating that the investment's cost is recoverable within a reasonable period of time outweighs evidence to the contrary
- The determination of whether a security can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its amortized cost
- The application of the model when the investor has certain types of guarantees or other credit enhancements associated with debt securities.

Determination of Whether Evidence Indicating That the Investment's Cost Is Recoverable within a Reasonable Period of Time Outweighs Evidence to the Contrary

Example 1

XYZ is developing a product that is highly anticipated by the market. On January 1, 20X2, Investor purchased 200,000 shares of XYZ stock at a cost of \$20 per share. On May 1, 20X2, a regulatory body informed XYZ that the product did not meet certain regulatory requirements and, therefore, would not receive the regulatory approval required to sell the product. On May 2, 20X2, XYZ issued a press release announcing the regulator's decision. XYZ also reiterated its belief that XYZ will ultimately obtain regulatory approval. However, no evidence exists to support its assertion at this time. XYZ's share price immediately declined from \$22 per share to \$11 per share, and traded in the \$10 to \$12 range through June 30, 20X2. No information is available to support a recovery of fair value up to (or beyond) the cost of the investment. Investor has the ability and intent to hold the investment for an indefinite period.

Evaluation: Despite Investor's ability and intent to hold the investment for an indefinite period, Investor should deem the investment other-than-temporarily impaired given:

- The severity of the decline
- The cause of the decline (that is, failure to obtain regulatory approval of a product)
- The absence of evidence to support a recovery of fair value up to (or beyond) the cost of the investment within a reasonable period of time.

Example 2

Assume the same facts and circumstances as Example 1, with the following exception: On June 15, 20X2, XYZ announced that it had identified a way to modify the product in order to satisfy the regulatory requirements, while maintaining the capabilities of the original product specification. In that announcement, XYZ stated that it intended to resubmit the product for regulatory approval and that the regulator was expected to rule on the modification. XYZ's share price immediately increased to \$17 per share and traded in the \$15 to \$18 per share range through June 30, 20X2.

Evaluation: If, based on Investor's judgment, the announcement supports a recovery of fair value up to (or beyond) the cost of the investment within a reasonable period of time, Investor would deem that the investment is not other-than-temporarily impaired at June 30, 20X2.

Determination of Whether a Security Can Contractually Be Prepaid or Otherwise Settled in Such a Way That the Investor Would Not Recover Substantially All of Its Amortized Cost

Example 3

Investor purchases \$100 million of 5-year debt at par. The bond pays a semiannual fixed coupon of 8 percent per annum. Principal is due at maturity. Issuer can contractually call the debt at any time after the three-year anniversary of its issuance. However, if Issuer exercises its option to call the debt, it must pay the principal amount plus any accrued but unpaid interest. Since this instrument was acquired at par, it cannot contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of the amortized cost.¹⁵

Example 4

Investor purchases \$100 million of 5-year debt at par. The bond pays interest semiannually. The interest rate resets every 6 months based on 6-month LIBOR plus 2 percent. Principal is due at maturity, and the bond is not prepayable. Although the interest payments vary based on changes in six-month LIBOR, this instrument could not contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its amortized cost.

Example 5

Investor purchases an existing mortgage-backed security ("MBS") on the secondary market. The security is backed by 30-year fixed rate mortgages, each mortgage paying a fixed rate of 8 percent. The mortgages were originated two years ago, and the MBS was also issued two years ago. Due to the decreases in interest rates since the issuance of the security, Investor purchased the security at a price of \$111 (par is \$100). Each of the mortgages in the trust contains a prepayment option for the borrower.¹⁶ In the event mortgages are prepaid, the holder of the MBS is contractually entitled to its share of the cash flows relating to the principal.

The holder of the MBS is entitled to its share of the stated amount of the underlying loans. This instrument can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its amortized cost (Investor would receive \$100 of its \$111 cost).

The Application of the Model When the Investor Has Certain Types of Guarantees or Other Credit Enhancements Associated With Debt Securities

Example 6

Investor purchases Series E Debentures issued by Company A. The contractual terms of the Debentures requires that Company A use the Debenture proceeds to purchase specified assets, and that the purchased assets serve as collateral to satisfy the Debentures in the event of

¹⁵ If the instrument was purchased at a premium, the investor would have to evaluate whether the prepayment risk coupled with the premium could result in the investor not recovering substantially all of its amortized cost.

¹⁶ Assume that the prepayment option is not required to be bifurcated under Statement 133.

Company A's failure to satisfy its required payment obligations. The contractual terms of the purchased debt security meet both criteria of paragraph 17 because (a) the collateral provides for assets to be transferred solely to reimburse the investor for failure of the investee to satisfy its required payment obligations and (b) the collateral is included in the contractual terms of the purchased debt security. Therefore, Investor should consider the collateral in determining whether it is probable that it will be unable to collect all amounts due according to the contractual terms of the debt security.

Example 7

Metropolis has an A credit rating and obtains credit insurance from Company F in order to enhance the credit rating of the municipal bonds to AAA. The contractual payments under the municipal bonds are guaranteed by Company F. The contractual terms of the debt security include the guarantee by Company F. Investor purchases a Metropolis municipal bond with the attached insurance. The contractual terms of the debt security meet both criteria of paragraph 17 because (a) the guarantee provides for payments to be made solely to reimburse the investor for failure of the investee to satisfy its required payment obligations and (b) the guarantee is included in the contractual terms of the purchased debt security. Therefore, Investor should consider the guarantee in determining whether it is probable that it will be unable to collect all amounts due according to the contractual terms of the debt security.

Example 8

Investor purchases a corporate bond from Company Z and purchases a credit enhancement from Bank Y to cover the credit risk associated with Company Z. The credit enhancement provides for payments to be made solely to reimburse the guaranteed party (investor) for failure of the debtor (Company Z) to satisfy its required payment obligations. In this example, the credit enhancement is not included in the contractual terms of the purchased debt security and, therefore, does not meet criteria (b) of paragraph 17. Accordingly, Investor may not consider the credit enhancement in determining whether it is probable that it will be unable to collect all amounts due according to the contractual terms of the debt security.

Exhibit 03-1C

EXAMPLE OF THE APPLICATION OF THE EITF CONSENSUS ON DISCLOSURES ABOUT INVESTMENTS IN AN UNREALIZED LOSS POSITION THAT ARE NOT OTHER-THAN-TEMPORARILY IMPAIRED¹⁷

The following table shows the gross unrealized losses and fair value of 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, 20X3.¹⁸

Description of Securities	Less than 12 months		12 months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury obligations and direct obligations of US 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

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 these 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 these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

¹⁷ This example illustrates the application of paragraphs 21 and 22 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 21(b), the investor should provide meaningful disclosure about individually significant unrealized losses.

¹⁸ 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 21, 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 consensus.

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 these investments at a discount relative to their face amount, and the contractual cash flows of these 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 these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

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 these 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 that 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.

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 these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

The Company's portfolio of common stocks in the air courier industry consists of investments in 4 companies, of which 3 (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 business has been adversely affected by the slow-down of the U.S. economy, particularly during the second half of 20X3 when the Company's investments became impaired. In addition, the credit rating of nearly all companies in the portfolio has 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 these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

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.

The remaining \$21 of cost method investments consists of one 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) correlates 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 this investment to be other-than-temporarily impaired at December 31, 20X3.