

## **FASB STAFF POSITION**

### **No. FAS 115-2 and FAS 124-2**

**Title:** Recognition and Presentation of Other-Than-Temporary Impairments

**Date Posted:** April 9, 2009

### **Objective**

1. The objective of an other-than-temporary impairment analysis under existing U.S. generally accepted accounting principles (GAAP) is to determine whether the holder of an investment in a debt or equity security for which changes in fair value are not regularly recognized in earnings (such as securities classified as held-to-maturity or available-for-sale) should recognize a loss in earnings when the investment is impaired. An investment is impaired if the fair value of the investment is less than its amortized cost basis.
2. This FASB Staff Position (FSP) amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities.

### **Background**

3. If the fair value of a debt security is less than its amortized cost basis at the measurement date, U.S. GAAP requires that an entity assess the impaired security to determine whether the impairment is other than temporary. Before this FSP, to conclude that an impairment was other than temporary an entity was required, among other considerations, to assert that it had the intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in fair value in accordance with SEC Staff Accounting Bulletin (SAB) Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and*

*Equity Securities*, and other authoritative literature. If the impairment was determined to be other-than-temporary, then an impairment loss was recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date.

4. On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the Act) was signed into law. Section 133 of the Act mandated that the U.S. Securities and Exchange Commission (SEC) conduct a study on mark-to-market accounting standards. The SEC submitted its study, *Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-To-Market Accounting*, to Congress on December 30, 2008. One of the recommendations in the study was that the FASB reassess current impairment accounting models for financial instruments. The SEC recommended that the FASB "evaluate the need for modifications (or the elimination) of current OTTI [other-than-temporary impairment] guidance to provide for a more uniform system of impairment testing standards for financial instruments." The SEC also noted that a model that would require that only credit losses be recognized in income with the remaining decline in fair value of an investment being recognized in other comprehensive income "has the potential to provide investors with both fair value information as well as transparent information regarding the cash flows management expects to receive by holding investments, rather than through accessing the market currently."

5. On January 12, 2009, the Board issued FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20*, to make the accounting for other-than-temporary impairments in EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets," more consistent with the accounting in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. However, constituents continued to express concerns that the requirements for recognition and measurement of impairment losses for investments in debt securities are different from those for loans. Those constituents also observed that financial statements do not provide users with sufficient information about the amount of cash the entity expects to collect by holding the

asset. Some constituents asserted that current market conditions have caused temporary declines in value that go well beyond the cash flows that are no longer expected to be collected.

6. This FSP incorporates other-than-temporary impairment guidance for debt securities from SAB Topic 5M and other authoritative literature, modifies and expands it to address the unique features of debt securities, and clarifies the interaction of the factors that should be considered when determining whether a debt security is other than temporarily impaired.

7. For debt securities, the Board is modifying the existing requirements that to avoid recognizing an other-than-temporary impairment an investor must assert that it has both the intent and the ability to hold a security for a period of time sufficient to allow for an anticipated recovery in its fair value to its amortized cost basis. Instead, the Board believes it is more operational for an entity to assess whether the entity (a) has the intent to sell the debt security or (b) more likely than not will be required to sell the debt security before its anticipated recovery (for example, if its cash or working capital requirements or contractual or regulatory obligations indicate that the debt security will be required to be sold before the forecasted recovery occurs). If either of these conditions is met, the investor must recognize an other-than-temporary impairment.

8. Additionally, the Board decided to modify the terminology used to assess the collectibility of cash flows from *probable that the investor will be unable to collect all amounts due to the recovery of the entire cost basis of the security* to clarify that an entity should not wait for an event of default or other actual shortfall of cash to conclude that some or all of the cash flows are not likely to be collected. In the Board's view, in assessing whether the entire amortized cost basis of the security will be recovered, the entity should compare the present value of the cash flows expected to be collected from the security with the amortized cost basis of the security. The Board intends that the term *cash flows expected to be collected* should represent the cash flows that the entity is likely to collect after a careful assessment of all available information, including the factors described in paragraph 25 of this FSP. The difference between the present value of the cash flows expected to be collected and the amortized cost basis is hereafter referred to as the *credit loss*.

9. In instances in which a determination is made that a credit loss exists but the entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis (that is, the amortized cost basis less any current-period credit loss), this FSP changes the presentation and amount of the other-than-temporary impairment recognized in the statement of earnings (or the “performance indicator” of not-for-profit entities within the scope of the AICPA Audit and Accounting Guide, *Health Care Organizations*). In those instances, the impairment is separated into (a) the amount of the total impairment related to the credit loss and (b) the amount of the total impairment related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings (or the performance indicator). The amount of the total impairment related to all other factors is recognized in other comprehensive income (or outside the performance indicator). The total other-than-temporary impairment is presented in the statement of earnings with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income. This new presentation provides additional information about the amounts that an entity does not expect to collect related to a debt security.

10. In instances in which a determination is made that a credit loss exists but the entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before the anticipated recovery of its remaining amortized cost basis, this FSP more closely aligns the amounts recognized in earnings for impairments of investments in debt securities and impairments of loans classified as held-for-investment. However, unlike loans, the total other-than-temporary impairment recognized in comprehensive income for a debt security reflects the difference between fair value and the security’s remaining amortized cost basis at the measurement date.

11. Investors have informed the Board that two key financial metrics they use in evaluating many financial institutions are Tangible Common Equity and Net Interest Margin. This FSP has little or no effect on total Tangible Common Equity. This FSP does not result in a change in the carrying amount of debt securities in the statement of financial position (that is, available-for-sale securities are reported at fair value and held-to-maturity securities are reported at their amortized cost basis unless they are other-than-temporarily impaired, in which case they are

adjusted to fair value at that time). However, this FSP does require that the portion of an other-than-temporary impairment not related to a credit loss for a held-to-maturity security be recognized in a new category of other comprehensive income and be amortized over the remaining life of the debt security as an increase in the carrying value of the security (with no effect on earnings unless the security is subsequently sold or there are additional decreases in cash flows expected to be collected). Compared with current requirements, this FSP does change the Net Interest Margin to better reflect the cash flows expected to be collected by an entity. It requires that the amortized cost basis of the security be adjusted by the credit loss only when the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its remaining amortized cost basis.

12. This FSP expands and increases the frequency of existing disclosures about other-than-temporary impairments for debt and equity securities. For example, it requires a more detailed, risk-oriented breakdown of major security types and related information currently required by Statement 115. In addition, this FSP requires that the annual disclosures in Statement 115 and FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, be made for interim periods (including the aging of securities with unrealized losses). This FSP also requires new disclosures to help users of financial statements understand the significant inputs used in determining a credit loss, as well as a rollforward of that amount each period. These collective disclosure enhancements significantly improve the information provided to users about impaired securities.

13. This FSP does not amend existing recognition and measurement guidance for other-than-temporary impairments of equity securities because the Board does not believe the requirement for an entity to assess whether the entity more likely than not will be required to sell a security before its recovery is more operational for equity securities.

14. The Board understands that the staff of the SEC's Office of the Chief Accountant plans to amend SAB Topic 5M to conform with the guidance for debt securities in this FSP.

15. Beyond making short-term changes in this FSP, the FASB has a joint project with the International Accounting Standards Board to more broadly improve and achieve convergence of their respective standards on accounting for financial instruments. That project is being

conducted on an expedited basis with a goal of working toward convergence. The FASB anticipates a joint Exposure Document will be issued later in 2009.

16. This FSP includes amendments to Statement 115 and FSP FAS 115-1 and FAS 124-1 and conforming changes to other standards, including Issue 99-20 and AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*.

**All paragraphs in this FSP have equal authority.  
Paragraphs in bold set out the main principles.**

## FASB Staff Position

### Scope

17. **The recognition guidance in paragraphs 19–34 of this FSP applies to debt securities classified as available-for-sale and held-to-maturity that are subject to other-than-temporary impairment guidance within:**

- a. **Statement 115**
- b. **FSP FAS 115-1 and FAS 124-1**
- c. **EITF Issue 99-20, as amended by FSP EITF 99-20-1**
- d. **AICPA Statement of Position 03-3.**

For debt securities that are within the scope of FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and that are held by an entity that reports a “performance indicator” as defined in AICPA Accounting and Audit Guide, *Health Care Organizations*, throughout this FSP, the term *earnings* shall be replaced with *performance indicator*, and *other comprehensive income* shall be replaced with *outside the performance indicator*.

18. **The presentation and disclosure guidance in paragraphs 35–43 of this FSP applies to debt and equity securities that are subject to the disclosure requirements of Statement 115 and FSP FAS 115-1 and FAS 124-1.**

### Recognition

#### **Evaluating Whether an Impairment of a Debt Security Is Other Than Temporary**

19. **If the fair value of a debt security is less than its amortized cost basis at the balance sheet date, an entity shall assess whether the impairment is other than temporary.** Amortized cost basis includes adjustments made to the cost of an investment for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized in earnings (less any cumulative-effect adjustments recognized in accordance with paragraphs 45 and 46 of this FSP), and fair value hedge accounting adjustments.

20. **If an entity intends to sell the debt security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.**

21. **If an entity does not intend to sell the debt security, the entity shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before a forecasted recovery occurs). If the entity more likely than not will be required to sell the security before recovery of its amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.**

22. **If the entity does not expect to recover the entire amortized cost basis of the security, the entity would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security. Therefore, in those situations, an other-than-temporary impairment shall be considered to have occurred.** In assessing whether the entire amortized cost basis of the security will be recovered, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. **If present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered (that is, a credit loss exists), and an other-than-temporary impairment shall be considered to have occurred.**

23. In determining whether a credit loss exists, an entity shall use its best estimate of the present value of cash flows expected to be collected from the debt security. One way of estimating that amount would be to consider the methodology described in paragraphs 12–16 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, for measuring an impairment on the basis of the present value of expected future cash flows. Paragraph 14 of Statement 114 provides guidance on this calculation. Briefly, the entity would discount the expected cash flows at the effective interest rate implicit in the security at the date of acquisition.

24. For debt securities that are beneficial interests in securitized financial assets within the scope of Issue 99-20, an entity shall determine the present value of cash flows expected to be

collected by considering the guidance in paragraph 12(b) of Issue 99-20 for determining whether there has been a decrease in cash flows expected to be collected from cash flows previously projected. In other words, the cash flows estimated at the current financial reporting date shall be discounted at a rate equal to the current yield used to accrete the beneficial interest. Additionally, for debt securities accounted for in accordance with SOP 03-3, an entity shall consider that standard in estimating the present value of cash flows expected to be collected from the debt security. A decrease in cash flows expected to be collected on an asset-backed security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of the present value of cash flows expected to be collected.

25. There are numerous factors to be considered when estimating whether a credit loss exists and the period over which the debt security is expected to recover. The following are a few examples of the factors that shall be considered. This list is not meant to be all-inclusive.

- a. The length of time and the extent to which the fair value has been less than the amortized cost basis
- b. Adverse conditions specifically related to the security, an industry, or a geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement)
- c. The historical and implied volatility of the fair value of the security
- d. The payment structure of the debt security (for example, nontraditional loan terms as described in FSP SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk*) and the likelihood of the issuer being able to make payments that increase in the future
- e. Failure of the issuer of the security to make scheduled interest or principal payments
- f. Any changes to the rating of the security by a rating agency
- g. Recoveries or additional declines in fair value subsequent to the balance sheet date.

26. In making its other-than-temporary impairment assessment, an entity shall consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of cash flows expected to be collected. That information generally should include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the entity should consider, for example, industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectibility of the security. An entity also should consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract as discussed in paragraph 8 of FSP FAS 115-1 and FAS 124-1) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by nontraditional loans). Thus, an entity should consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including “balloon” payments). An entity also should consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, an entity needs to assess the effect of that decline on the ability of the entity to collect the balloon payment.

**Determination of the Amount of an Other-Than-Temporary Impairment Recognized in Earnings and Other Comprehensive Income**

**27. When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss.**

28. If an entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between

the investment's amortized cost basis and its fair value at the balance sheet date. In assessing whether the entity more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses, an entity shall consider the factors in paragraph 25.

29. If an entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into (a) the amount representing the credit loss and (b) the amount related to all other factors.

30. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

31. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in fair value. However, the amortized cost basis shall be adjusted for accretion and amortization as prescribed in paragraph 32.

#### **Accounting for Debt Securities after an Other-Than-Temporary Impairment**

32. **An entity 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 at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized in earnings.** For debt securities for which other-than-temporary impairments were recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted in accordance with existing guidance as interest income. An entity shall continue to estimate the present value of cash flows expected to be collected over the life of the debt security. For debt securities accounted for in accordance with Issue 99-20, an entity should look to that standard to account for changes in cash flows expected to be collected. For all other debt securities, if upon subsequent evaluation, there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows

previously expected, such changes shall be accounted for as a prospective adjustment to the accretable yield in accordance with SOP 03-3 even if the debt security would not otherwise be within the scope of that standard. This 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.

***Debt Securities Classified as Available-for-Sale***

33. Subsequent increases and decreases (if not an additional other-than-temporary impairment) in the fair value of available-for-sale securities shall be included in other comprehensive income.

***Debt Securities Classified as Held-to-Maturity***

34. The other-than-temporary impairment recognized in other comprehensive income for debt securities classified as held-to-maturity shall be accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows. That accretion shall increase the carrying value of the security and shall continue until the security is sold, the security matures, or there is an additional other-than-temporary impairment that is recognized in earnings. If the security is sold, paragraphs 8 and 11 of Statement 115 provide guidance on the effect of changes in circumstances that would not call into question the entity's intent to hold other debt securities to maturity in the future.

**Presentation**

35. **In periods in which an entity determines that a security's decline in fair value below its amortized cost basis is other than temporary, the entity shall present the total other-than-temporary impairment in the statement of earnings with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income in accordance with paragraph 30, if any.**

36. The following is an example of the presentation on the face of the statement of earnings:

|  |            |
|--|------------|
| Total other-than-temporary impairment losses | (\$10,000) |
|--|------------|

|   |                   |
|---|-------------------|
| Portion of loss recognized in other comprehensive income (before taxes) | <u>4,000</u>      |
| Net impairment losses recognized in earnings                            | <u>(\$ 6,000)</u> |

37. An entity also shall separately present, in the financial statement where the components of accumulated other comprehensive income are reported, amounts recognized therein related to held-to-maturity and available-for-sale debt securities for which a portion of an other-than-temporary impairment has been recognized in earnings.

### **Disclosures**

38. **An entity shall disclose information for interim and annual periods that enables users of its financial statements to understand the types of available-for-sale and held-to-maturity debt and equity securities held, including information about investments in an unrealized loss position for which an other-than-temporary impairment has or has not been recognized. In addition, for interim and annual periods, an entity shall disclose information that enables users of financial statements to understand the reasons that a portion of an other-than-temporary impairment of a debt security was not recognized in earnings and the methodology and significant inputs used to calculate the portion of the total other-than-temporary impairment that was recognized in earnings.**

39. In satisfying the principle in paragraph 38 an entity shall identify major security types consistent with how it manages, monitors, and measures its securities on the basis of the nature and risks of the security. An entity shall consider the (shared) activity or business sector, vintage, geographic concentration, credit quality, or economic characteristic in determining whether disclosure for a particular security type is necessary and whether it is necessary to separate further a particular security type in greater detail. When complying with the disclosure requirements in paragraph 19 of Statement 115, a financial institution shall include the following major security types, although additional types also may be necessary: equity securities (segregated by industry type, company size, or investment objective); debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies; debt securities issued by states of the United States and political subdivisions of the states; debt securities issued by foreign governments; corporate debt securities; residential mortgage-backed securities; commercial mortgage-backed securities; collateralized debt obligations; and other

debt obligations. For purposes of this requirement, the term *financial institutions* includes banks, savings and loan associations, savings banks, credit unions, finance companies, and insurance companies.

40. For securities classified as available-for-sale or held-to-maturity, an entity shall disclose the amortized cost basis by major security type that the entity discloses in accordance with Statement 115 as of each date (interim and annual) for which a statement of financial position is presented. Additionally, an entity shall provide all disclosures required by Statement 115 on a quarterly basis.

41. An entity shall disclose, by major security type, the information required by FSP FAS 115-1 and FAS 124-1 for each interim and annual reporting period presented. The information required by paragraph 17 of FSP FAS 115-1 and FAS 124-1 also shall be presented for debt securities for which an other-than-temporary impairment was recognized and only the amount related to a credit loss was recognized in earnings.

42. For periods in which an other-than-temporary impairment of a debt security is recognized and only the amount related to a credit loss was recognized in earnings, an entity shall disclose, by major security type, the methodology and significant inputs used to measure the amount related to the credit loss. Examples of significant inputs include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan to collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings.

43. For each interim and annual reporting period presented, an entity shall disclose a tabular rollforward of the amount related to credit losses recognized in earnings in accordance with paragraph 30, which shall include at a minimum:

- a. The beginning balance of the amount related to credit losses on debt securities held by the entity at the beginning of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income
- b. Additions for the amount related to the credit loss for which an other-than-temporary impairment was not previously recognized

- c. Reductions for securities sold during the period (realized)
- d. Reductions for securities for which the amount previously recognized in other comprehensive income was recognized in earnings because the entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis
- e. Additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized when the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis
- f. Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security (see paragraph 32)
- g. The ending balance of the amount related to credit losses on debt securities held by the entity at the end of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

### **Effective Date and Transition**

44. The FSP shall be effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Earlier adoption for periods ending before March 15, 2009, is not permitted. If an entity elects to adopt early either FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, or FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*, the entity also is required to adopt early this FSP. Additionally, if an entity elects to adopt early this FSP, it is required to adopt FSP FAS 157-4. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial adoption. In periods after initial adoption, this FSP requires comparative disclosures only for periods ending after initial adoption.

45. This FSP shall be applied to existing and new investments held by an entity as of the beginning of the interim period in which it is adopted (for example, as of April 1, 2009, if an entity adopts the FSP for periods ending after June 15, 2009). For debt securities held at the beginning of the interim period of adoption for which an other-than-temporary impairment was

previously recognized, if an entity does not intend to sell and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis (after considering the guidance in paragraphs 19–26 of this FSP), the entity shall recognize the cumulative effect of initially applying this FSP as an adjustment to the opening balance of retained earnings with a corresponding adjustment to accumulated other comprehensive income. The cumulative effect on retained earnings shall be calculated by comparing the present value of the cash flows expected to be collected determined in accordance with the methodology in paragraphs 23 and 24 with the amortized cost basis of the debt security as of the beginning of the interim period in which this FSP is adopted. The cumulative-effect adjustment shall include related tax effects. The discount rate used to calculate the present value of the cash flows expected to be collected shall be the rate in effect before recognizing any other-than-temporary impairments and not a rate that has been adjusted to reflect those impairments.

46. The amortized cost basis of a security for which an other-than-temporary impairment was previously recognized shall be adjusted by the amount of the cumulative-effect adjustment before taxes. The difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted in accordance with existing guidance as interest income (see paragraph 32).

47. In the period of adoption, an entity shall provide the disclosures required by FASB Statement No. 154, *Accounting Changes and Error Corrections*, for changes in accounting principles.

**The provisions of this FSP need  
not be applied to immaterial items.**

*This FSP was adopted by the affirmative votes of three members of the Financial Accounting Standards Board. Messrs. Linsmeier and Siegel dissented.*

Messrs. Linsmeier and Siegel dissent from issuance of this FSP for two reasons. First, they believe that to the extent there is an other-than-temporary impairment, it should be measured as the entire difference between the fair value and the carrying value of the impaired item with that change fully reflected in net income as an unrealized loss. Messrs. Linsmeier and Siegel believe that investors generally have opined that their preference is for the fair value of financial instruments to be reflected in net income. While other financial statement users might have different views, the difference in opinion often is due to concerns about regulatory capital, as most users find increased worth in fair value information. Messrs. Linsmeier and Siegel note that investors changed their focus in recent months from analyzing Tier One Capital to Tangible Common Equity. Tier One Capital reverses from regulatory capital unrealized fair value losses on securities reported in other comprehensive income. In the current markets, investors are focusing more on Tangible Common Equity consistent with a preference for reporting full fair value changes in capital. Critical to this analysis is the inclusion of unrealized fair value losses on debt and equity securities within net income and not other comprehensive income. This FSP serves to increase the unrealized losses reported in other comprehensive income, exacerbating investors' concerns with Tier One Capital information. Thus, Messrs. Linsmeier and Siegel do not believe that investors generally will be served by requiring a bifurcation of the fair value write-down between net income and other comprehensive income, as is required in certain circumstances by this FSP.

Messrs. Linsmeier and Siegel believe that the primary purpose of financial reporting is to serve investors; therefore, if a bifurcation of the full fair value change into credit and noncredit components is needed to facilitate bank regulators in their regulatory capital decisions, that bifurcation should be provided on the face of the income statement with both components recognized in earnings consistent with investors' preferences. Bank regulators then can choose whether or not to include the noncredit portion of the fair value change in their regulatory capital requirements. Messrs. Linsmeier and Siegel also object to bifurcating the impairment loss into credit and noncredit components because they do not believe the expected loss approach (as prescribed in this FSP) can isolate the credit loss from other losses (particularly liquidity risk) as is advocated by those supporting this approach. In current market conditions, liquidity risk is

inextricably intertwined with credit risk, representing the discount associated with uncertainty about the collectibility of contractual cash flows in the security.

Second, Messrs. Linsmeier and Siegel object to the change in the trigger for the nonrecognition of the full impairment loss in net income. The previous GAAP requirements permitted nonrecognition of the full impairment loss when an entity could assert its intent and ability to hold the instrument to recovery of its amortized cost basis. Instead, this FSP permits nonrecognition of the noncredit portion of the full impairment loss in net income if the entity can assert that it does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery to its amortized cost basis. While Messrs. Linsmeier and Siegel understand that the primary objective of this change is to make the held-to-recovery concept more operational, they also recognize that a likely result of this change is a reduction in the amount of impairment losses recognized in net income. A 1991 U.S. Treasury report cited delayed recognition of impairment losses as having an exacerbating effect on the length and ultimate cost of the savings and loan crisis. There also are potential parallels to the experience in Japan when delays in recognition of losses resulted in the so-called lost decade in the 1990s. Similarly, Messrs Linsmeier and Siegel are concerned that to the extent the proposed FSP results in delayed recognition of impairment losses in net income, there also may be a negative effect on investor confidence.

Finally, Messrs. Linsmeier and Siegel believe that there potentially may be other standard-setting issues that need to be addressed within the current other-than-temporary impairment model. However, they would prefer to address those concerns in the joint medium-term project with the International Accounting Standards Board (IASB). Messrs. Linsmeier and Siegel believe that there is a high risk that the unilateral change to the recognition and presentation of other-than-temporary impairments could create the opportunity for an “accounting arbitrage” with pressure for FASB and IASB standards to converge to the standard perceived most lenient. In addition, when one standard setter enacts changes on its own, there is a failure to achieve convergence of accounting standards, which continues the challenges faced by investors in comparing global financial institutions reporting under two different accounting models.

*Members of the Financial Accounting Standards Board:*

Robert H. Herz, *Chairman*  
Thomas J. Linsmeier  
Leslie F. Seidman  
Marc A. Siegel  
Lawrence W. Smith

## Appendix A

### AMENDMENTS TO EXISTING PRONOUNCEMENTS

A1. FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

- a. Paragraph 50 as amended:

Realized gains and losses on all investments (except those that are accounted for as either hedges of net investments in foreign operations or cash flow hedges as described in Statement 133) shall be reported in the statement of earnings as a component of other income, on a pretax basis. Realized gains and losses shall be presented as a separate item in the statement of earnings or disclosed in the notes to the financial statements. Realized gains and losses shall not be deferred, either directly or indirectly. Realized gains and losses on the sale of assets other than investments, such as real estate used in the business, shall be reported in accordance with APB Opinion No. 30, *Reporting the Results of Operations*. Losses arising from an other-than-temporary impairment shall be presented in accordance with FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*.

A2. FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, is amended as follows:

- a. Paragraph 16, and its related footnote 4, as amended:

For individual securities classified as either available-for-sale or held-to-maturity, an enterprise shall determine whether a decline in fair value below the amortized cost basis is other than temporary. (If a security has been the hedged item in a fair value hedge, the security's "amortized cost basis" shall reflect the effect of the adjustments of its carrying amount made pursuant to paragraph 22(b) of Statement 133.) ~~For example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred.<sup>4</sup> If the decline in fair value is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write down shall be included in earnings (that is, accounted for as a realized loss). The enterprise shall apply the guidance in FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, to determine whether the decline in fair value is other than temporary and how an other-than-temporary impairment should be recognized. The amortized cost basis shall be written down by the amount of an other-than-temporary impairment recognized in earnings. The new amortized cost basis shall not be~~

changed for subsequent recoveries in fair value. Subsequent increases in the fair value of available-for-sale securities shall be included in other comprehensive income pursuant to paragraph 13; subsequent decreases in fair value, if not an other-than-temporary impairment, also shall be included in other comprehensive income.

<sup>4</sup>~~A decline in the value of a security that is other than temporary is also discussed in FSP FAS115 1 and FAS124 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*.~~

- b. Paragraph 18A is added after the heading "Disclosures" as follows:

The disclosures in this Statement are required for interim and annual periods.

- c. Paragraph 19, as amended:

For securities classified as available-for-sale, all reporting enterprises shall disclose the amortized cost basis, the aggregate fair value, the total other-than-temporary impairment recognized in accumulated other comprehensive income, the total gains for securities with net gains in accumulated other comprehensive income, and the total losses for securities with net losses in accumulated other comprehensive income, by major security type as of each date for which a statement of financial position is presented. For securities classified as held-to-maturity, all reporting enterprises shall disclose the amortized cost basis, the aggregate fair value, gross unrecognized holding gains, gross unrecognized holding losses, the net carrying amount, the total other-than-temporary impairment recognized in accumulated other comprehensive income, and the gross gains and losses in accumulated other comprehensive income for any derivatives that hedged the forecasted acquisition of the held-to-maturity securities, by major security type as of each date for which a statement of financial position is presented. Major security types shall be based on the nature and risks of the security. An enterprise should consider the (shared) activity or business sector, vintage, geographic concentration, credit quality, or economic characteristic in determining whether disclosure for a particular security type is necessary and whether it is necessary to further separate a particular security type into greater detail. In complying with this requirement, financial institutions<sup>6</sup> shall include in their disclosure the following major security types, although additional types also may be necessary included as appropriate:

- a. Equity securities (segregated by industry type, company size, or investment objective)
- b. Debt securities issued by the U.S. Treasury and other U.S. government corporations and agencies
- c. Debt securities issued by states of the United States and political subdivisions of the states
- d. Debt securities issued by foreign governments

- e. Corporate debt securities
- f. Residential Mortgage-backed securities
- g. Commercial mortgage-backed securities
- h. Collateralized debt obligations
- gi. Other debt securities obligations.

A3. FASB Statement No. 130, *Reporting Comprehensive Income*, is amended as follows:

- a. Paragraph 17, as amended:

Items included in other comprehensive income shall be classified based on their nature. For example, under existing accounting standards, other comprehensive income shall be classified separately into foreign currency items, gains or losses associated with pension or other postretirement benefits, prior service costs or credits associated with pension or other postretirement benefits, transition assets or obligations associated with pension or other postretirement benefits, ~~and~~ unrealized gains and losses on ~~certain investments in~~ debt and equity securities classified as available-for-sale, and amounts recognized in other comprehensive income for debt securities classified as available-for-sale and held-to-maturity related to an other-than-temporary impairment recognized in accordance with FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, when a portion of the impairment was not recognized in earnings. Additional classifications or additional items within current classifications may result from future accounting standards.

- b. Paragraph 19:

An enterprise shall determine reclassification adjustments for each classification of other comprehensive income, except as noted in paragraph 19A. The requirement for a reclassification adjustment for Statement 52 foreign currency translation adjustments is limited to translation gains and losses realized upon sale or upon complete or substantially complete liquidation of an investment in a foreign entity.

- c. Paragraph 19A is added as follows:

An enterprise shall only determine reclassification adjustments for amounts recognized in other comprehensive income related to other-than-temporary impairments of debt securities classified as held-to-maturity when the loss is realized as a result of a sale of the security or an additional credit loss occurs. If the security is sold, paragraphs 8 and 11 of Statement 115 provide guidance on the effect of changes in circumstances that would not call into question the entity's intent to hold other debt securities to maturity in the future. If the held-to-maturity debt security is not sold and additional credit losses do not occur, the amount recognized in other comprehensive income shall be accounted for in accordance with FSP FAS 115-1 and FAS 124-1 (that is, the amount shall be

amortized over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows).

A4. FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, is amended as follows:

a. Paragraph 3A is added as follows:

FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the recognition, presentation, and disclosure guidance in this FSP.

b. Paragraph 4b:

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*. Throughout this standard, the term *earnings* shall be replaced with *performance indicator*, and *other comprehensive income* shall be replaced with *outside the performance indicator* for debt securities that are within the scope of Statement 124.

c. Footnote 2:

Amortized ~~cost~~ basis includes adjustments made to the ~~cost basis~~ of an investment for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized in earnings (less any cumulative-effect adjustments recognized in accordance with the transition provisions of FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*), and ~~hedging fair value hedge accounting adjustments~~.

d. Paragraph 13:

When the fair value of an investment is less than its amortized cost basis at the balance sheet date of the reporting period for which impairment is assessed, the impairment is either temporary or other than temporary.<sup>4</sup> In addition to the guidance in this FSP, 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 Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets."

e. Paragraph 13A and its related heading are added as follows:

**Equity Securities**

For equity securities, an investor shall apply guidance that is pertinent to the determination of whether an impairment is other than temporary, such as SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*, and other authoritative literature.

- f. Paragraphs 14A–14G and their related heading are added as follows:

**Debt Securities**

14A. If an investor intends to sell the debt security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.

14B. If an investor does not intend to sell the debt security, the investor shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before a forecasted recovery occurs). If the investor more likely than not will be required to sell the security before recovery of its amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.

14C. If an investor does not expect to recover the entire amortized cost basis of the security, the investor would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security. Therefore, in those situations, an other-than-temporary impairment shall be considered to have occurred. In assessing whether the entire amortized cost basis of the security will be recovered, an investor shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis of the security, the entire amortized cost basis of the security will not be recovered (that is, a credit loss exists), and an other-than-temporary impairment shall be considered to have occurred.

14D. In determining whether a credit loss exists, an investor shall use its best estimate of the present value of cash flows expected to be collected from the debt security. One way of estimating that amount would be to consider the methodology described in paragraphs 12–16 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, for measuring an impairment on the basis of the present value of expected future cash flows. Paragraph 14 of Statement 114 provides guidance on this calculation. Briefly,

the investor would discount the expected cash flows at the effective interest rate implicit in the security at the date of acquisition.

14E. For debt securities that are beneficial interests in securitized financial assets within the scope of Issue 99-20, an investor shall determine the present value of cash flows expected to be collected considering the guidance in paragraph 12(b) of Issue 99-20 for determining whether there has been a decrease in cash flows expected to be collected from cash flows previously projected. In other words, the cash flows estimated at the current financial reporting date shall be discounted at a rate equal to the current yield used to accrete the beneficial interest. Additionally, for debt securities accounted for in accordance with AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, an entity shall consider that standard in estimating the present value of cash flows expected to be collected from the debt security. A decrease in cash flows expected to be collected on an asset-backed security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of the present value of cash flows expected to be collected.

14F. There are numerous factors to be considered when estimating whether a credit loss exists and the period over which the debt security is expected to recover. The following are a few examples of the factors that shall be considered. This list is not meant to be all inclusive.

- a. The length of time and the extent to which the fair value has been less than the amortized cost basis
- b. Adverse conditions specifically related to the security, an industry, or geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement)
- c. The historical and implied volatility of the fair value of the security
- d. The payment structure of the debt security (for example, nontraditional loan terms as described in FSP SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk*) and the likelihood of the issuer being able to make payments that increase in the future
- e. Failure of the issuer of the security to make scheduled interest or principal payments
- f. Any changes to the rating of the security by a rating agency
- g. Recoveries or additional declines in fair value subsequent to the balance sheet date.

14G. In making its other-than-temporary impairment assessment, an investor shall consider all available information relevant to the collectibility of the

security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of cash flows expected to be collected. That information generally should include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the investor should consider, for example, industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectibility of the security. An investor also should consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract as discussed in paragraph 8) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by nontraditional loans). Thus, an investor should consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including “balloon” payments). An investor also should consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, an investor needs to assess the effect of that decline on the ability of the investor to collect the balloon payment.

- g. The headings before paragraph 15:

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

**Equity Securities—If the Impairment Is Other Than Temporary, Recognize an Impairment Loss Equal to the Difference between the Investment’s Cost Basis and Its Fair Value**

- h. Paragraphs 15A–15E and their related heading are added as follows:

**Debt Securities—Determination of the Amount of an Other-Than-Temporary Impairment Recognized in Earnings and Other Comprehensive Income**

15A. When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether an investor intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss.

15B. If an investor intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's amortized cost basis and its fair value at the balance sheet date. In assessing whether the investor more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses, the investor shall consider the factors in paragraph 14F.

15C. If an investor does not intend to sell the security and it is not more likely than not that the investor will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into the following:

- a. The amount representing the credit loss
- b. The amount related to all other factors.

15D. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

15E. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in fair value. However, the amortized cost basis shall be adjusted for accretion and amortization as prescribed in paragraph 16.

- i. Paragraph 16 and its related heading:

**ACCOUNTING FOR DEBT SECURITIES SUBSEQUENT TO AFTER  
AN OTHER-THAN-TEMPORARY IMPAIRMENT**

In periods ~~subsequent to~~ after the recognition of an other-than-temporary impairment loss for debt securities,<sup>5</sup> 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 at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized in earnings. 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. For debt securities for which other-than-temporary impairments were recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted in accordance with existing applicable guidance as interest income. An investor shall continue to estimate the present value of cash flows expected to be collected over the life of the debt

security. For debt securities accounted for in accordance with Issue 99-20, an investor should look to that standard to account for changes in cash flows expected to be collected. For all other debt securities, if upon subsequent evaluation, there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, such changes shall be accounted for as a prospective adjustment to the accretable yield in accordance with SOP 03-3 even if the debt security would not otherwise be within the scope of that standard. Subsequent increases and decreases (if not an other-than-temporary impairment) in the fair value of available-for-sale securities shall be included in other comprehensive income.

- j. Paragraphs 16A–16C and their related heading are added as follows:

16A. The other-than-temporary impairment recognized in other comprehensive income for debt securities classified as held-to-maturity shall be accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows. That accretion shall increase the carrying value of the security and shall continue until the security is sold, the security matures, or there is an additional other-than-temporary impairment that is recognized in earnings. If the security is sold, paragraphs 8 and 11 of Statement 115 provide guidance on the effect of changes in circumstances that would not call into question the investor’s intent to hold other debt securities to maturity in the future.

**Presentation**

16B. In periods in which an investor determines that a security’s decline in fair value below its amortized cost basis is other than temporary, the investor shall present the total other-than-temporary impairment in the statement of earnings with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income, in accordance with paragraph 15D, if any. The following is an example of the presentation on the face of the statement of earnings:

|  |            |
|--|------------|
| Total other-than-temporary impairment losses                               | (\$10,000) |
| Portion of loss recognized in other comprehensive<br>income (before taxes) | 4,000      |
| Net impairment losses recognized in earnings                               | (\$ 6,000) |

16C. An investor also shall separately present, in the financial statement where the components of accumulated other comprehensive income are reported, amounts recognized therein related to held-to-maturity and available-for-sale debt securities for which a portion of an other-than-temporary impairment has been recognized in earnings.

k. Paragraph 17:

For all investments in an unrealized loss<sup>6</sup> position, including those that fall within the scope of Issue 99-20, for which other-than-temporary impairments have not been recognized in earnings, an investor shall disclose the following in its interim and annual financial statements (included in this disclosure are investments for which a portion of an other-than-temporary impairment has been recognized in other comprehensive income):

- 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~~ major security type 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 amortized cost basis 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 the total amount by which amortized cost basis exceeds fair value as an other-than-temporary impairment in earnings or (b) the investor becoming aware of a recovery of fair value up to (or beyond) the amortized cost basis of the investment during the period.

- 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, performance indicators of the underlying assets in the security (including default rates, delinquency rates and percentage of nonperforming assets), loan to collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, industry analyst reports, sector credit ratings, volatility of the security's fair value, and/or any other information that the investor considers relevant.

l. Paragraph 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 interim and 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 annual fair values under FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*, or
  - (3) The investor is exempt from estimating interim fair values because it does not meet the definition of a publicly traded company, as defined by APB Opinion No. 28, *Interim Financial Reporting*.

m. Paragraphs 18A and 18B are added as follows:

18A. For interim and annual periods in which an other-than-temporary impairment of a debt security is recognized and only the amount related to a credit loss was recognized in earnings, an investor shall disclose by major security type, the methodology and significant inputs used to measure the amount related to credit loss. Examples of significant inputs include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan to collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings.

18B. For each interim and annual reporting period presented, an investor shall disclose a tabular rollforward of the amount related to credit losses recognized

in earnings in accordance with paragraph 15D, which shall include at a minimum:

- a. The beginning balance of the amount related to credit losses on debt securities held by the investor at the beginning of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income
- b. Additions for the amount related to the credit loss for which an other-than-temporary impairment was not previously recognized
- c. Reductions for securities sold during the period(realized)
- d. Reductions for securities for which the amount previously recognized in other comprehensive income was recognized in earnings because the investor intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis
- e. Additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized when the investor does not intend to sell the security and it is not more likely than not that the investor will be required to sell the security before recovery of its amortized cost basis
- f. Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security (refer to paragraph 16)
- g. The ending balance of the amount related to credit losses on debt securities held by the entity at the end of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income.

n. Paragraph 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 bases of the investments. Because the Company ~~has the ability and intent to hold those investments until a recovery of fair value~~ does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 20X3.

o. Paragraph 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 bases of the Company's investments. 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~~ does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 20X3.

p. Paragraph 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 basis 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 Manufacturing Company to settle the debentures would not be settled~~ at a price less than the amortized cost basis of the investment (that is, the Company expects to recover the entire amortized cost basis of the security). Because the Company ~~has the ability and intent to hold this investment until a recovery of fair value~~ does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, 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. APB Opinion No. 28, *Interim Financial Reporting*, is amended as follows:

a. Paragraphs 30(o) and 30(p) are added as follows:

o. The information about certain investments in debt and equity securities as required by FASB Statement No. 115, *Accounting for Investments in Certain Debt and Equity Securities*.

p. The information about other-than-temporary impairments as required by FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*.

A6. EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets,” is amended as follows:

a. Paragraph 12, as amended:

[The original Task Force consensus was superseded by FSP EITF 99-20-1 and FSP FAS 115-2 and FAS 124-2.] The holder of a beneficial interest should continue to update the estimate of cash flows over the life of the beneficial interest. If upon evaluation:

- a. Based on current information and events ~~it is probable that~~ there is a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected, then the investor should recalculate the amount of accretable yield for the beneficial interest on the date of evaluation as the excess of ~~estimated~~ cash flows expected to be collected over the beneficial interest’s reference amount (the reference amount is equal to (1) the initial investment less (2) cash received to date less (3) other-than-temporary impairments recognized in earnings to date [as described in paragraph 12(b)] plus (4) the yield accreted to date). The adjustment should be accounted for prospectively as a change in estimate in conformity with Statement 154 [Note: See paragraph 25 of the Status section.], with the amount of periodic accretion adjusted over the remaining life of the beneficial interest. Based on ~~estimated~~ cash flows expected to be collected, interest income may be recognized on a beneficial interest even if the net investment in the beneficial interest is accreted to an amount greater than the amount at which the beneficial interest could be settled if prepaid immediately in its entirety.
- b. The fair value of the beneficial interest has declined below its reference amount, an enterprise should determine whether the decline is other-than-temporary. An entity should apply the impairment of securities guidance in paragraph 16 of Statement 115 and the related implementation guidance (see paragraphs 13, 13A, 13B, and 15 of this Issue). If based on current information and events ~~it is probable that~~ there has been an adverse change in ~~estimated~~ cash flows expected to be collected (in accordance with paragraph 12(a) above), then (1) an other-than-temporary impairment should be considered to have occurred and (2) the beneficial interest should be written down to fair value with the resulting change being ~~included in income~~ recognized in accordance with FSP FAS 115-1 and FAS 124-1. Determining whether there has been a favorable (or an adverse) change in ~~estimated~~ cash flows expected to be collected from the cash flows previously projected (taking into consideration both the timing and amount of the estimated cash flows) involves comparing the present value of the remaining cash flows as estimated at the initial transaction date (or at the last date previously revised) against the present value of the cash flows ~~estimated~~ expected to be collected at the current financial reporting date. The

cash flows should be discounted at a rate equal to the current yield used to accrete the beneficial interest. If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is less than the present value of the current estimated of cash flows expected to be collected, the change is considered favorable (that is, an other-than-temporary impairment should be considered to have not occurred under the consensus in this Issue). If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is greater than the present value of the current estimated cash flows, the change is considered adverse (that is, an other-than-temporary impairment should be considered to have occurred under the consensus in this Issue). However, absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a “plain-vanilla,” variable-rate beneficial interest generally should not result in the recognition of an other-than-temporary impairment (see footnote 2, Exhibit 99-20A) (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater).

b. Paragraph 15, as amended:

~~The Task Force observes that, consistent with Topic No. D-44, “Recognition of Other Than Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value,” FSP FAS 115-1 and FAS 124-1 when an entity intends to sell a specifically identified beneficial interest classified as available-for-sale for which fair value is less than the amortized cost basis, at a loss shortly after the balance sheet date whose fair value is less than its carrying amount and the entity does not expect the fair value to recover prior to the expected time of the sale, a write-down for other-than-temporary impairment should be recognized in earnings ~~in the period in which the decision to sell is made.~~ [Note: See paragraph 28 of the STATUS section.] Furthermore, SAB 59, SAS 92, the Statement 115 Special Report, and FSP FAS115-1/124-1 provide additional guidance to consider when determining whether an other-than-temporary impairment exists. ~~SAB Topic 5M states, “[The holder does not have] the intent and ability . . . to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.”~~~~

c. Paragraph 29A is added as follows:

FSP FAS 115-2 and FAS 124-2, issued in April 2009, amends paragraphs 12 and 15 of Issue 99-20. These amendments are conforming changes that reflect the Board’s decisions to amend guidance for recognizing and presenting other-than-temporary impairments. All instances of the term *estimated cash flows* in this Issue should be replaced with the term *cash flows expected to be collected*.

A7. EITF Topic D-41: "Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of FASB Statement No. 115," is amended as follows:

[For ease of use, only the portion of the Subsequent Developments section affected by this Statement has been reproduced.]

### **Subsequent Developments**

In June 1997, the FASB issued Statement 130, which amends Statement 115 to require that unrealized gains and losses on available-for-sale securities be reported in other comprehensive income. The accumulated balance of those changes in value continues to be reported in a separate component of shareholders' equity until realized.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which amends FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, to require that an entity separately present, in the financial statement where the components of accumulated other comprehensive income are reported, amounts recognized in accumulated other comprehensive income related to held-to-maturity and available-for-sale debt securities for which an other-than-temporary impairment has been recognized and only the portion related to a credit loss is recognized in earnings.

No further EITF discussion is planned.

A8. Q&A 115—*A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*, is amended as follows:

a. Question 46, as amended:

~~46. Q—Paragraph 16 provides an example of when a decline in the fair value of a debt security is other than temporary. What other factors indicate that impairment is other than temporary? How is an equity security evaluated for other than temporary impairment?~~

~~A—Statement 115 does not specifically address these questions, but refers to three other sources of literature that should be considered in evaluating impairment: FASB Staff Position FAS 115-1/124-1, *The Meaning of Other Than-Temporary Impairment and Its Application to Certain Investments*, SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairments of Certain Investments in Debt and Equity Securities*, and AICPA Statement on Auditing Standards (SAS) No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*. Although paragraph 16 of Statement 115 mentions a decline in a security's value due to a deterioration in the issuer's creditworthiness, recognition of other than temporary impairment also may be required if the~~

~~decline in a security's value is due to an increase in market interest rates or a change in foreign exchange rates since acquisition. Examples of when a decline in the fair value of a debt security may be other than temporary include situations where the security will be disposed of before it matures or the investment is not realizable (also see paragraph 47 of SAS 92 and paragraph 6.39 of the AICPA Audit Guide, *Auditing Derivative Instruments, Hedging Activities, and Investments, in Securities*. [Revised 9/99; 9/01; 11/05.]~~

b. Question 47, as amended:

47. Q—Should an enterprise recognize other-than-temporary impairment when it decides to sell a specific available-for-sale debt security at a loss shortly after the balance sheet date?

A—Generally, yes, if the enterprise intends to sell the security (that is, a decision has been made to sell the security) does not expect the fair value of the security to recover prior to the expected time of sale. In that case, the write-down for the other-than-temporary impairment would be recognized in earnings in the period in which the *decision to sell* is made, not the period in which the sale occurs. Refer to FSP FAS 115-1/124-1 and the two documents in the appendix to this implementation guide for additional information. [Revised 11/05; 4/09.]

c. Question 48:

48. Q—May a valuation allowance be used to recognize impairment on securities subject to Statement 115?

A—No. Paragraph 16 requires that each individual security be evaluated for impairment, ~~and, when impairment is identified, "the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings."~~ Guidance for determining whether an impairment is other than temporary and how an other-than-temporary impairment should be recognized is provided in FSP FAS 115-1 and FAS 124-1. Providing a general allowance for unidentified impairment in a portfolio of securities is not appropriate. [Revised 4/09.]

A9. AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, is amended as follows:

a. Paragraph .07:

*Loan accounted for as a debt security.* An investor should continue to estimate cash flows expected to be collected over the life of the loan. If, upon subsequent evaluation:

- a. The fair value of the debt security has declined below its **amortized cost** basis, an entity should determine whether the decline is other than

temporary. An entity should apply the impairment of securities guidance in paragraph 16 of FASB Statement No. 115 and FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. For example, if ~~it is probable~~, based on current information and events, ~~that~~ there is a decrease in cash flows expected to be collected (that is, the investor is unable to collect all cash flows expected at acquisition plus any additional cash flows expected to be collected arising from changes in estimate after acquisition (in accordance with paragraph .07b of this SOP), an other-than-temporary impairment should be considered to have occurred. The investor should consider both the timing and amount of cash flows expected to be collected in making a determination about whether it is probable that the investor is unable to collect all cash flows expected at acquisition plus any additional there has been a decrease in cash flows expected to be collected arising from changes in estimates after acquisition.

- b. Based on current information and events, ~~it is probable that~~ there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, the investor should recalculate the amount of accretable yield for the loan as the excess of the revised cash flows expected to be collected over the sum of (1) the initial investment less (2) cash collected less (3) other-than-temporary impairments plus (4) amount of yield accreted to date. The investor should adjust the amount of accretable yield by reclassification from nonaccretable difference. The adjustment should be accounted for as a change in estimate in conformity with FASB Statement No. 154, *Accounting Changes and Error Corrections* Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*, with the amount of periodic accretion adjusted over the remaining life of the loan.

- b. Paragraph A-6 and its heading:

***Illustration—Scenario C***

***Base Case With Decrease in Cash Flows Expected for Years 20X3–X5***

***Accounted for as a Debt Security***

***A-6. Change in Expectations.*** Assume instead that, at December 31, 20X2, Company A determines that the loan accounted for as a debt security has incurred an other-than-temporary impairment of \$232,163 recognized in earnings in accordance with FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. The Company does not recognize any additional other-than-temporary impairments in other comprehensive income because the entire impairment relates to a decrease in cash flows expected to be collected. Company A estimates that ~~it is probable~~

that cash flows expected to be collected will be \$100,000 less in each of the remaining three years than expected at acquisition. Using the new carrying amount (amortized cost basis) of \$2,472,850 and the remaining cash flows expected to be collected, the effective interest rate would be calculated as 14 percent effective interest rate of 14 percent, the present value of the remaining cash flows expected to be collected is calculated as \$2,472,850. Following are the resulting calculations.

| <u>Year Ended<br/>December 31</u> | <u>Beginning<br/>Carrying<br/>Amount</u> | <u>Cash Flows<br/>Expected<br/>to Be Collected</u> | <u>Interest<br/>Income<sup>6</sup></u> | <u>Reduction<br/>of Carrying<br/>Amount</u> | <u>Ending<br/>Carrying<br/>Amount</u> |
|-----------------------------------|--|--|--|---|---------------------------------------|
| 20X1                              | \$4,000,000                              | \$1,165,134  | \$560,000                              | \$605,134                                   | \$3,394,866                           |
| 20X2                              | 3,394,866                                | <u>1,165,134</u>                                   | <u>475,281</u>                         | <u>922,016<sup>7</sup></u>                  | 2,472,850                             |
| Totals for years<br>20X1–X2       |  | <u>\$2,330,268</u>                                 | <u>\$1,035,281</u>                     | <u>\$1,527,150</u>                          |                                       |
| 20X3                              | \$2,472,850                              | \$1,065,134  | \$346,199                              | \$718,935                                   | \$1,753,915                           |
| 20X4                              | 1,753,915                                | 1,065,134  | 245,548                                | 819,586                                     | 934,329                               |
| 20X5                              | 934,329                                  | <u>1,065,134</u>                                   | <u>130,805</u>                         | <u>934,329</u>                              | —                                     |
| Totals for years<br>20X3–X5       |  | <u>\$3,195,402</u>                                 | <u>\$722,552</u>                       | <u>\$2,472,850</u>                          |                                       |
| Totals for years<br>20X1–X5       |  | <u>\$5,525,670</u>                                 | <u>\$1,757,833</u>                     | <u>\$4,000,000</u>                          |                                       |

<sup>6</sup> The yield recognized is 14.00 percent for years 20X1 through 20X5. In this example the yield imputed after the write-down remains at 14 percent, but this would not always be the result.

<sup>7</sup> The reduction of carrying amount includes an amount representing the decrease in cash flows expected to be collected allowance for loan losses of \$232,163 for a loan not accounted for as a debt security and a write-down of \$232,163 for recognized as an other-than-temporary impairment in earnings a loan accounted for as a debt security.

Measurement of Impairment

|   |                    |
|---|--------------------|
| Recorded amount <del>before prior to</del> change in estimate                               | \$2,705,013        |
| Less: Present value of cash flows expected to be collected                                  | <u>(2,472,850)</u> |
| <u>Measured Other-than-temporary impairment recognized in earnings at December 31, 20X2</u> | <u>\$232,163</u>   |
|   | =====              |

Recalculation of Accrutable Yield

|                                     |             |
|-------------------------------------|-------------|
| Remaining cash flows expected to be | \$3,195,402 |
|-------------------------------------|-------------|

collected, December 31, 20X2

Less the sum of:

|   |                   |
|---|-------------------|
| Initial investment  | \$4,000,000       |
| Less: Cash collected to date  | (2,330,268)       |
| Less: <u>Other-than-temporary impairment recognized in earnings</u><br><del>Write-downs and allowance</del> | (232,163)         |
| Plus: Yield accreted to date  | <u>1,035,281</u>  |
|   | <u>2,472,850</u>  |
| Remaining accretable yield as recalculated  | 722,552           |
| Less: Unadjusted balance at December 31, 20X2   | <u>(790,389)</u>  |
| Adjustment needed to accretable yield   | <u>\$(67,837)</u> |
|   | =====             |

Proof:

|   |                  |
|---|------------------|
| Total decrease in cash flows expected to be collected   | \$300,000        |
| <del>Present value of total decrease</del> <u>Other-than-temporary impairment recognized in earnings</u><br>(current period loss) | <u>(232,163)</u> |
| Future accretable yield no longer expected  | \$67,837         |
|   | =====            |

- c. Paragraph A-7(a) and its heading (A-7(a) is now part of A-6):

**~~Accounted for as a Debt Security~~**

~~A-7(a)~~. If Company A receives the cash flows as expected in years 20X1 and 20X2 but at the end of 20X2 determines cash flows will be \$100,000 less in each of years 20X3 through 20X5, the following is a summary of the effects of that activity.

|                  | <i>A</i>  | <i>B</i>                                     | <i>C</i>                                      | <i>D</i>                    | <i>E</i>                           |
|------------------|---|--|---|-----------------------------|------------------------------------|
|                  | <u>Contractually<br/>Required<br/>Payments<br/>Receivable</u> | <u>Cash Expected<br/>to Be<br/>Collected</u> | <u>Nonaccretable<br/>Difference<br/>A - B</u> | <u>Accretable<br/>Yield</u> | <u>Debt<br/>Security<br/>B - D</u> |
| Acquisition 20X1 | \$7,500,000   | \$5,825,670                                  | \$1,674,330                                   | \$1,825,670                 | \$4,000,000                        |
| collections      | <u>(1,165,134)</u>  | <u>(1,165,134)</u>                           | _____   | <u>(560,000)</u>            | <u>(605,134)</u>                   |
| Balance 20X2     | 6,334,866   | 4,660,536                                    | 1,674,330                                     | 1,265,670                   | 3,394,866                          |

**FSP FAS 115-2 and FAS 124-2**

|                    |                    |                              |                    |                  |                  |
|--------------------|--------------------|------------------------------|--------------------|------------------|------------------|
| collections        | (1,165,134)        | (1,165,134)                  |                    | (475,281)        | (689,853)        |
| <u>Other-than-</u> |                    |                              |                    |                  |                  |
| <u>temporary</u>   |                    |                              |                    |                  |                  |
| <u>impairment</u>  |                    |                              |                    |                  |                  |
| Balance            | <u>5,169,732</u>   | <u>(300,000)<sup>8</sup></u> | <u>300,000</u>     | <u>(67,837)</u>  | <u>(232,163)</u> |
| 20X3               |                    |                              |                    |                  |                  |
| collections        | <u>(1,065,134)</u> | <u>(1,065,134)</u>           |                    | <u>(346,199)</u> | <u>(718,935)</u> |
| Balance            | <u>4,104,598</u>   | <u>2,130,268</u>             | <u>1,974,330</u>   | <u>376,353</u>   | <u>1,753,915</u> |
| 20X4               |                    |                              |                    |                  |                  |
| collections        | <u>(1,065,134)</u> | <u>(1,065,134)</u>           |                    | <u>(245,548)</u> | <u>(819,586)</u> |
| Balance            | <u>3,039,464</u>   | <u>1,065,134</u>             | <u>1,974,330</u>   | <u>130,805</u>   | <u>934,329</u>   |
| 20X5               |                    |                              |                    |                  |                  |
| collections        | <u>(1,065,134)</u> | <u>(1,065,134)</u>           |                    | <u>(130,805)</u> | <u>(934,329)</u> |
| Balance            | <u>1,974,330</u>   | <u>—</u>                     | <u>1,974,330</u>   | <u>—</u>         | <u>—</u>         |
|                    |                    | \$ =====                     |                    | \$ =====         | \$ =====         |
| Disposition        | <u>(1,974,330)</u> |                              | <u>(1,974,330)</u> |                  |                  |
|                    | \$ =====           |                              | \$ =====           |                  |                  |

<sup>8</sup> The \$300,000 decrease in cash flows expected to be collected represents \$67,837 of interest income (accrutable yield) foregone that had been expected at acquisition to be earned and \$232,163 of carrying amount that will not be recovered. ~~The \$300,000 decrease in cash flows expected to be collected results in a loss of \$232,163 (recorded as a write-off) and foregone interest income in future years of \$67,837.~~

|             | <u>Debt</u>      | <u>Debt</u>      |                  |             | <u>Interest</u>            |
|-------------|------------------|------------------|------------------|-------------|----------------------------|
|             | <u>Security</u>  | <u>Allowance</u> | <u>Security</u>  | <u>Loss</u> | <u>Income</u> <sup>9</sup> |
| Acquisition | \$4,000,000      |                  | \$4,000,000      |             | \$(4,000,000)              |
| 20X1        |                  |                  |                  |             |                            |
| collections | <u>(605,134)</u> |                  | <u>(605,134)</u> |             | 1,165,134                  |
| Balance     | <u>3,394,866</u> |                  | <u>3,394,866</u> |             | \$560,000                  |
| 20X2        |                  |                  |                  |             |                            |
| collections | <u>(689,853)</u> |                  | <u>(689,853)</u> |             | 1,165,134                  |
| Impairment  | <u>(232,163)</u> |                  | <u>(232,163)</u> | \$232,163   | 475,281                    |
| Balance     | <u>2,472,850</u> |                  | <u>2,472,850</u> |             |                            |
| 20X3        |                  |                  |                  |             |                            |
| collections | <u>(718,935)</u> |                  | <u>(718,935)</u> |             | 1,065,134                  |
| Balance     | <u>1,753,915</u> |                  | <u>1,753,915</u> |             | 346,199                    |
| 20X4        |                  |                  |                  |             |                            |
| collections | <u>(819,586)</u> |                  | <u>(819,586)</u> |             | 1,065,134                  |
| Balance     | <u>934,329</u>   |                  | <u>934,329</u>   |             | 245,548                    |
| 20X5        |                  |                  |                  |             |                            |
| collections | <u>(934,329)</u> |                  | <u>(934,329)</u> |             | 1,065,134                  |
| Balance     | <u>—</u>         |                  | <u>—</u>         | \$232,163   | \$1,757,833                |
|             | \$ =====         |                  | \$ =====         | =====       | =====                      |

<sup>9</sup> The accretable yield recognized as interest income for years 20X3 through 20X5 remains at 14.00 percent would be the discount rate that equates the adjusted carrying amount (that is, after recognition of the decrease in cash flows expected to be received on the security) to the cash flows expected to be collected. Under the assumptions given, this rate remains at 14 percent in this example.

d. Paragraph A-7(b) and its heading (A-7(b) is now part of A-7):

[The purpose of this amendment is to provide separate examples for loans and debt securities. There have been no changes to the guidance for accounting for loans in SOP 03-3.]

***Accounted for as a Loan***

***A-7. Change in Expectations.*** Assume instead that, at December 31, 20X2, Company A determines it is probable that cash flows expected to be collected will be \$100,000 less in each of the remaining 3 years than expected at acquisition. Using the effective interest rate of 14 percent, the present value of the remaining cash flows expected to be collected is calculated as \$2,472,850. Following are the resulting calculations.

| <u>Year Ended</u><br><u>December 31</u>   | <u>Beginning</u><br><u>Carrying</u><br><u>Amount</u> | <u>Cash Flows</u><br><u>Expected</u><br><u>to Be Collected</u> | <u>Interest</u><br><u>Income</u> <sup>9a</sup> | <u>Reduction</u><br><u>of Carrying</u><br><u>Amount</u> | <u>Ending</u><br><u>Carrying</u><br><u>Amount</u> |
|---|--|--|--|---|---|
| <u>20X1</u>                               | <u>\$4,000,000</u>                                   | <u>\$1,165,134</u>   | <u>\$560,000</u>                               | <u>\$605,134</u>  | <u>\$3,394,866</u>                                |
| <u>20X2</u>                               | <u>3,394,866</u>                                     | <u>1,165,134</u>   | <u>475,281</u>                                 | <u>922,016</u> <sup>9b</sup>                            | <u>2,472,850</u>                                  |
| <u>Totals for years</u><br><u>20X1–X2</u> |  | <u>\$2,330,268</u>   | <u>\$1,035,281</u>                             | <u>\$1,527,150</u>                                      |   |
| <u>20X3</u>                               | <u>\$2,472,850</u>                                   | <u>\$1,065,134</u>   | <u>\$346,199</u>                               | <u>\$718,935</u>  | <u>\$1,753,915</u>                                |
| <u>20X4</u>                               | <u>1,753,915</u>                                     | <u>1,065,134</u>   | <u>245,548</u>                                 | <u>819,586</u>  | <u>934,329</u>                                    |
| <u>20X5</u>                               | <u>934,329</u>                                       | <u>1,065,134</u>   | <u>130,805</u>                                 | <u>934,329</u>  | <u>—</u>  |
| <u>Totals for years</u><br><u>20X3–X5</u> |  | <u>\$3,195,402</u>   | <u>\$722,552</u>                               | <u>\$2,472,850</u>                                      |   |
| <u>Totals for years</u><br><u>20X1–X5</u> |  | <u>\$5,525,670</u>   | <u>\$1,757,833</u>                             | <u>\$4,000,000</u>                                      |   |

<sup>9a</sup> The yield recognized is 14.00 percent for years 20X1 through 20X5.

<sup>9b</sup> The reduction of carrying amount includes an allowance for loan losses of \$232,163 for a loan not accounted for as a debt security.

*Measurement of Impairment*

|   |                    |
|---|--------------------|
| <u>Recorded amount before change in estimate</u>                  | <u>\$2,705,013</u> |
| <u>Less: Present value of cash flows expected to be collected</u> | <u>(2,472,850)</u> |
| <u>Measured impairment at December 31, 20X2</u>                   | <u>\$232,163</u>   |
|   | =====              |

*Recalculation of Accretable Yield*

|   |                    |
|---|--------------------|
| <u>Remaining cash flows expected to be collected, December 31, 20X2</u> | <u>\$3,195,402</u> |
| <u>Less the sum of:</u>   |                    |
| <u>Initial investment</u>   | <u>\$4,000,000</u> |
| <u>Less: Cash collected to date</u>                                     | <u>(2,330,268)</u> |
| <u>Less: allowance</u>  | <u>(232,163)</u>   |
| <u>Plus: Yield accreted to date</u>                                     | <u>1,035,281</u>   |
|   | <u>2,472,850</u>   |
| <u>Remaining accretable yield as recalculated</u>                       | <u>722,552</u>     |
| <u>Less: Unadjusted balance at December 31, 20X2</u>                    | <u>(790,389)</u>   |
| <u>Adjustment needed to accretable yield</u>                            | <u>\$(67,837)</u>  |
|   | =====              |

*Proof:*

|  |                  |
|--|------------------|
| <u>Total decrease in cash flows expected to be collected</u> | <u>\$300,000</u> |
| <u>Present value of total decrease (current period loss)</u> | <u>(232,163)</u> |
| <u>Future accretable yield no longer expected</u>            | <u>\$67,837</u>  |
|  | =====            |

**A-7(b).** If Company A receives the cash flows as expected in years 20X1 and 20X2 but at the end of 20X2 determines cash flows will be \$100,000 less in each of years 20X3 through 20X5, the following is a summary of the effects of that activity.

|                  | A   | B  | C   | D                           | E                                     |
|------------------|---|--|---|-----------------------------|---------------------------------------|
|                  | <i>Contractually<br/>Required<br/>Payments<br/>Receivable</i> | <i>Cash Expected<br/>to Be<br/>Collected</i> | <i>Nonaccretable<br/>Difference<br/>A - B</i> | <i>Accretable<br/>Yield</i> | <i>Loans<br/>Receivable<br/>B - D</i> |
| Acquisition 20X1 | \$7,500,000   | \$5,825,670                                  | \$1,674,330                                   | \$1,825,670                 | \$4,000,000                           |
| collections      | <u>(1,165,134)</u>  | <u>(1,165,134)</u>                           | _____   | <u>(560,000)</u>            | <u>(605,134)</u>                      |

**FSP FAS 115-2 and FAS 124-2**

|             |                    |                                |                    |                  |                         |
|-------------|--------------------|--------------------------------|--------------------|------------------|-------------------------|
| Balance     | 6,334,866          | 4,660,536                      | 1,674,330          | 1,265,670        | 3,394,866               |
| 20X2        |                    |                                |                    |                  |                         |
| collections | (1,165,134)        | (1,165,134)                    |                    | (475,281)        | (689,853)               |
| Impairment  |                    | <u>(300,000)</u> <sup>10</sup> | 300,000            | <u>(67,837)</u>  | <u>(232,163)</u>        |
| Balance     | 5,169,732          | 3,195,402                      | 1,974,330          | 722,552          | 2,472,850 <sup>11</sup> |
| 20X3        |                    |                                |                    |                  |                         |
| collections | <u>(1,065,134)</u> | <u>(1,065,134)</u>             |                    | <u>(346,199)</u> | <u>(718,935)</u>        |
| Balance     | 4,104,598          | 2,130,268                      | 1,974,330          | 376,353          | 1,753,915               |
| 20X4        |                    |                                |                    |                  |                         |
| collections | <u>(1,065,134)</u> | <u>(1,065,134)</u>             |                    | <u>(245,548)</u> | <u>(819,586)</u>        |
| Balance     | 3,039,464          | 1,065,134                      | 1,974,330          | 130,805          | 934,329                 |
| 20X5        |                    |                                |                    |                  |                         |
| collections | <u>(1,065,134)</u> | <u>(1,065,134)</u>             |                    | <u>(130,805)</u> | <u>(934,329)</u>        |
| Balance     | 1,974,330          | —                              | 1,974,330          | —                | —                       |
|             |                    | \$ =====                       |                    | \$ =====         | \$ =====                |
| Disposition | <u>(1,974,330)</u> |                                | <u>(1,974,330)</u> |                  |                         |
|             | \$ =====           |                                | \$ =====           |                  |                         |

<sup>10</sup> The \$300,000 decrease in cash flows expected to be collected represents \$67,837 of interest income (accretable yield) foregone that had been expected at acquisition to be earned and \$232,163 of carrying amount that will not be recovered. The \$300,000 decrease in cash flows expected to be collected results in a loss of \$232,163 (recorded as an allowance for loan loss) and foregone interest income in future years of \$67,837.

<sup>11</sup> For a loan (not accounted for as a debt security) with an allowance, this amount equals the net loans receivable.

|             | <u>Loans</u>      |                    | <u>Net Loans</u>  | <u>Bad Debt</u> |                  | <u>Interest</u>             |
|-------------|-------------------|--------------------|-------------------|-----------------|------------------|-----------------------------|
|             | <u>Receivable</u> | <u>Allowance</u>   | <u>Receivable</u> | <u>Expense</u>  | <u>Cash</u>      | <u>Income</u> <sup>12</sup> |
| Acquisition | \$4,000,000       |                    | \$4,000,000       |                 | \$(4,000,000)    |                             |
| 20X1        |                   |                    |                   |                 |                  |                             |
| collections | <u>(605,134)</u>  |                    | <u>(605,134)</u>  |                 | 1,165,134        | \$560,000                   |
| Balance     | 3,394,866         |                    | 3,394,866         |                 |                  |                             |
| 20X2        |                   |                    |                   |                 |                  |                             |
| collections | (689,853)         |                    | (689,853)         |                 | 1,165,134        | 475,281                     |
| Impairment  |                   | <u>\$(232,163)</u> | <u>(232,163)</u>  | \$232,163       |                  |                             |
| Balance     | 2,705,013         | (232,163)          | 2,472,850         |                 |                  |                             |
| 20X3        |                   |                    |                   |                 |                  |                             |
| collections | <u>(718,935)</u>  |                    | <u>(718,935)</u>  |                 | 1,065,134        | 346,199                     |
| Balance     | 1,986,078         | (232,163)          | 1,753,915         |                 |                  |                             |
| 20X4        |                   |                    |                   |                 |                  |                             |
| collections | <u>(819,586)</u>  |                    | <u>(819,586)</u>  |                 | 1,065,134        | 245,548                     |
| Balance     | 1,166,492         | (232,163)          | 934,329           |                 |                  |                             |
| 20X5        |                   |                    |                   |                 |                  |                             |
| collections | <u>(934,329)</u>  |                    | <u>(934,329)</u>  |                 | <u>1,065,134</u> | <u>130,805</u>              |
| Balance     | 232,163           | (232,163)          | —                 | \$232,163       | \$1,525,670      | \$1,757,833                 |
|             |                   |                    | \$ =====          | =====           | =====            | =====                       |

Disposition            (232,163)            232,163

\$ ===== \$ =====

<sup>12</sup> The accretable yield recognized as interest income for years 20X3 through 20X5 remains at 14.00 percent.

e. Paragraph A-9(a)(1):

**A-9(a)(1).** If the loan is accounted for as a debt security, the entire subsequent increase in cash flows expected to be collected is recorded as a yield adjustment on a prospective basis because the earlier ~~write-down~~ other-than-temporary impairment write down recognized in earnings may not be reversed. Following is a summary of activity.

| <u>Year Ended</u><br><u>December 31</u> | <u>Beginning</u><br><u>Carrying</u><br><u>Amount</u> | <u>Cash Flows</u><br><u>Expected</u><br><u>to Be Collected</u> | <u>Interest</u><br><u>Income</u> <sup>13</sup> | <u>Reduction</u><br><u>of Carrying</u><br><u>Amount</u> | <u>Ending</u><br><u>Carrying</u><br><u>Amount</u> |
|---|--|--|--|---|---|
| 20X1                                    | \$4,000,000  | \$1,165,134  | \$560,000                                      | \$605,134   | \$3,394,866                                       |
| 20X2                                    | 3,394,866  | 1,165,134  | 475,281  | 922,016 <sup>14</sup>                                   | 2,472,850   |
| 20X3                                    | 2,472,850  | <u>1,065,134</u>   | <u>346,199</u>                                 | <u>718,935</u>  | 1,753,915   |
| Totals for years<br>20X1–X3             |  | <u>\$3,395,402</u>   | <u>\$1,381,480</u>                             | <u>\$2,246,085</u>                                      |   |
| 20X4                                    | \$1,753,915  | \$1,115,134  | \$309,219                                      | \$805,915   | \$948,000   |
| 20X5                                    | 948,000  | <u>1,115,134</u>   | <u>167,134</u>                                 | <u>948,000</u>  | —   |
| Totals for years<br>20X4–X5             |  | <u>\$2,230,268</u>   | <u>\$476,353</u>                               | <u>\$1,753,915</u>                                      |   |
| Totals for years<br>20X1–X5             |  | <u>\$5,625,670</u>   | <u>\$1,857,833</u>                             | <u>\$4,000,000</u>                                      |   |

<sup>13</sup> The yield recognized is 14.00 percent for years 20X1 through 20X3 and 17.6302 percent for years 20X4 and 20X5.

<sup>14</sup> The reduction of carrying amount includes a ~~write-down~~ recognition in earnings of an other-than-temporary impairment of \$232,163.

f. Paragraph A-9(a)(2):

**A-9(a)(2).** If Company A receives the cash flows as indicated above, the following is a summary of the effects of that activity.

| <i>A</i>                                | <i>B</i>             | <i>C</i> | <i>D</i> | <i>E</i> |
|---|----------------------|----------|----------|----------|
| <i>Contractually</i><br><i>Required</i> | <i>Cash Expected</i> |          |          |          |

**FSP FAS 115-2 and FAS 124-2**

|   | <u>Payments<br/>Receivable</u> | <u>to Be<br/>Collected</u>  | <u>Nonaccretable<br/>Difference<br/>A - B</u> | <u>Accretable<br/>Yield</u> | <u>Debt<br/>Security<br/>B - D</u> |
|---|--------------------------------|-----------------------------|---|-----------------------------|------------------------------------|
| Acquisition                                     | \$7,500,000                    | \$5,825,670                 | \$1,674,330                                   | \$1,825,670                 | \$4,000,000                        |
| 20X1  |                                |                             |   |                             |                                    |
| collections                                     | <u>(1,165,134)</u>             | <u>(1,165,134)</u>          | <u>                    </u>                   | <u>(560,000)</u>            | <u>(605,134)</u>                   |
| Balance   | 6,334,866                      | 4,660,536                   | 1,674,330                                     | 1,265,670                   | 3,394,866                          |
| 20X2  |                                |                             |   |                             |                                    |
| collections                                     | (1,165,134)                    | (1,165,134)                 |   | (475,281)                   | (689,853)                          |
| <u>Other-then-<br/>temporary<br/>impairment</u> | <u>                    </u>    | <u>(300,000)</u>            | <u>300,000</u>                                | <u>(67,837)</u>             | <u>(232,163)</u>                   |
| Balance   | 5,169,732                      | 3,195,402                   | 1,974,330                                     | 722,552                     | 2,472,850                          |
| 20X3  |                                |                             |   |                             |                                    |
| collections                                     | <u>(1,065,134)</u>             | <u>(1,065,134)</u>          | <u>                    </u>                   | <u>(346,199)</u>            | <u>(718,935)</u>                   |
| Balance   | 4,104,598                      | 2,130,268                   | 1,974,330                                     | 376,353                     | 1,753,915                          |
| Increase in cash<br>flows expected              |                                | 100,000 <sup>15</sup>       | (100,000)                                     | 100,000                     |                                    |
| 20X4  |                                |                             |   |                             |                                    |
| collections                                     | <u>(1,115,134)</u>             | <u>(1,115,134)</u>          | <u>                    </u>                   | <u>(309,219)</u>            | <u>(805,915)</u>                   |
| Balance   | 2,989,464                      | 1,115,134                   | 1,874,330                                     | 167,134                     | 948,000                            |
| 20X5  |                                |                             |   |                             |                                    |
| collections                                     | <u>(1,115,134)</u>             | <u>(1,115,134)</u>          | <u>                    </u>                   | <u>(167,134)</u>            | <u>(948,000)</u>                   |
| Balance   | 1,874,330                      | <u>                    </u> | 1,874,330                                     | <u>                    </u> | <u>                    </u>        |
|   |                                | \$ =====                    |   | \$ =====                    | \$ =====                           |
| Disposition                                     | <u>(1,874,330)</u>             |                             | <u>(1,874,330)</u>                            |                             |                                    |
|   | \$ =====                       |                             | \$ =====                                      |                             |                                    |

<sup>15</sup> The \$100,000 increase in cash flows expected to be collected results in a reclassification of nonaccretable difference to accretable yield.

|             | <u>Debt<br/>Security</u> | <u>Allowance</u> | <u>Debt<br/>Security</u> | <u>Loss</u> | <u>Cash</u>   | <u>Interest<br/>Income</u> <sup>16</sup> |
|-------------|--------------------------|------------------|--------------------------|-------------|---------------|--|
| Acquisition | \$4,000,000              |                  | \$4,000,000              |             | \$(4,000,000) |  |
| 20X1        |                          |                  |                          |             |               |  |
| collections | <u>(605,134)</u>         |                  | <u>(605,134)</u>         |             | 1,165,134     | \$560,000                                |
| Balance     | 3,394,866                |                  | 3,394,866                |             |               |  |
| 20X2        |                          |                  |                          |             |               |  |
| collections | (689,853)                |                  | (689,853)                |             | 1,165,134     | 475,281                                  |
| Impairment  | <u>(232,163)</u>         |                  | <u>(232,163)</u>         | \$232,163   |               |  |
| Balance     | 2,472,850                |                  | 2,472,850                |             |               |  |
| 20X3        |                          |                  |                          |             |               |  |
| collections | <u>(718,935)</u>         |                  | <u>(718,935)</u>         |             | 1,065,134     | 346,199                                  |

**FSP FAS 115-2 and FAS 124-2**

|             |                  |                  |           |                  |                |
|-------------|------------------|------------------|-----------|------------------|----------------|
| Balance     | 1,753,915        | 1,753,915        |           |                  |                |
| 20X4        |                  |                  |           |                  |                |
| collections | <u>(805,915)</u> | <u>(805,915)</u> |           | 1,115,134        | 309,219        |
| Balance     | 948,000          | 948,000          |           |                  |                |
| 20X5        |                  |                  |           |                  |                |
| collections | <u>(948,000)</u> | <u>(948,000)</u> |           | <u>1,115,134</u> | <u>167,134</u> |
| Balance     | —                | —                | \$232,163 | \$1,625,670      | \$1,857,833    |
|             | \$ =====         | \$ =====         | =====     | =====            | =====          |

<sup>16</sup> Because the loan is accounted for as a debt security, the reduction in cash flows evaluated at the end of 20X2 resulted in recognition in earnings of an other-than-temporary impairment that may not be reversed. The increase in the accretable yield is recognized as interest income on a prospective basis resulting in an increase in yield for years 20X4 and 20X5 from 14.00 percent to 17.6302 percent.

g. Paragraph A-11(a)(1):

**A-11(a)(1).** If the loan is accounted for as a debt security, the entire subsequent increase in cash flows expected to be collected is recorded as a yield adjustment on a prospective basis because the earlier ~~write-down~~ recognition in earnings of other-than-temporary impairment that may not be reversed. Following is a summary of the activity.

| <u>Year Ended</u><br><u>December 31</u> | <u>Beginning</u><br><u>Carrying</u><br><u>Amount</u> | <u>Cash Flows</u><br><u>Expected</u><br><u>to Be Collected</u> | <u>Interest</u><br><u>Income</u> <sup>23</sup> | <u>Reduction</u><br><u>of Carrying</u><br><u>Amount</u> | <u>Ending</u><br><u>Carrying</u><br><u>Amount</u> |
|---|--|--|--|---|---|
| 20X1                                    | \$4,000,000  | \$1,165,134  | \$560,000                                      | \$605,134   | \$3,394,866                                       |
| 20X2                                    | 3,394,866  | 1,165,134  | 475,281  | 922,016 <sup>24</sup>                                   | 2,472,850   |
| 20X3                                    | 2,472,850  | <u>1,065,134</u>   | <u>346,199</u>                                 | <u>718,935</u>  | 1,753,915   |
| Totals for years<br>20X1–X3             |  | <u>\$3,395,402</u>   | <u>\$1,381,480</u>                             | <u>\$2,246,085</u>                                      |   |
| 20X4                                    | \$1,753,915  | \$1,315,134  | \$558,653                                      | \$756,481   | \$997,434   |
| 20X5                                    | 997,434  | <u>1,315,134</u>   | <u>317,700</u>                                 | <u>997,434</u>  | —   |
| Totals for years<br>20X4–X5             |  | <u>\$2,630,268</u>   | <u>\$876,353</u>                               | <u>\$1,753,915</u>                                      |   |
| Totals for years<br>20X1-X5             |  | <u>\$6,025,670</u>   | <u>\$2,257,833</u>                             | <u>\$4,000,000</u>                                      |   |
|   |  | =====  | =====  | =====   |   |

<sup>23</sup> The yield recognized is 14.00 percent for years 20X1 through 20X3 and 31.8518 percent for years 20X4 and 20X5. Interest income exceeds the difference in cash flows expected to be collected and the acquisition price by \$232,163, which is the amount of the other-than-temporary impairment recognized in 20X2 that may not be reversed.

<sup>24</sup> The reduction of carrying amount includes a ~~write-down~~ other-than-temporary impairment of \$232,163 recognized in earnings.

h. Paragraph A-11(a)(2):

**A-11(a)(2).** If Company A receives the cash flows as indicated above, the following is a summary of the effects of that activity.

|                                    | <i>A</i>  | <i>B</i>                                     | <i>C</i>                                      | <i>D</i>                    | <i>E</i>                           |
|------------------------------------|---|--|---|-----------------------------|------------------------------------|
|                                    | <i>Contractually<br/>Required<br/>Payments<br/>Receivable</i> | <i>Cash Expected<br/>to Be<br/>Collected</i> | <i>Nonaccretable<br/>Difference<br/>A - B</i> | <i>Accretable<br/>Yield</i> | <i>Debt<br/>Security<br/>B - D</i> |
| Acquisition                        | \$7,500,000   | \$5,825,670                                  | \$1,674,330                                   | \$1,825,670                 | \$4,000,000                        |
| 20X1                               |   |  |   |                             |                                    |
| collections                        | <u>(1,165,134)</u>  | <u>(1,165,134)</u>                           | <u>          </u>                             | <u>(560,000)</u>            | <u>(605,134)</u>                   |
| Balance                            | 6,334,866   | 4,660,536                                    | 1,674,330                                     | 1,265,670                   | 3,394,866                          |
| 20X2                               |   |  |   |                             |                                    |
| collections                        | (1,165,134)   | (1,165,134)                                  |   | (475,281)                   | (689,853)                          |
| Impairment                         |   | <u>(300,000)</u>                             | <u>300,000</u>                                | <u>(67,837)</u>             | <u>(232,163)</u>                   |
| Balance                            | 5,169,732   | 3,195,402                                    | 1,974,330                                     | 722,552                     | 2,472,850                          |
| 20X3                               |   |  |   |                             |                                    |
| collections                        | <u>(1,065,134)</u>  | <u>(1,065,134)</u>                           | <u>          </u>                             | <u>(346,199)</u>            | <u>(718,935)</u>                   |
| Balance                            | 4,104,598   | 2,130,268                                    | 1,974,330                                     | 376,353                     | 1,753,915                          |
| Increase in cash<br>flows expected |   | 500,000 <sup>25</sup>                        | (500,000)                                     | 500,000                     |                                    |
| 20X4                               |   |  |   |                             |                                    |
| collections                        | <u>(1,315,134)</u>  | <u>(1,315,134)</u>                           | <u>          </u>                             | <u>(558,653)</u>            | <u>(756,481)</u>                   |
| Balance                            | 2,789,464   | 1,315,134                                    | 1,474,330                                     | 317,700                     | 997,434                            |
| 20X5                               |   |  |   |                             |                                    |
| collections                        | <u>(1,315,134)</u>  | <u>(1,315,134)</u>                           | <u>          </u>                             | <u>(317,700)</u>            | <u>(997,434)</u>                   |
| Balance                            | 1,474,330   |  | 1,474,330                                     |                             |                                    |
|                                    |   | \$ =====                                     |   | \$ =====                    | \$ =====                           |
| Disposition                        | <u>(1,474,330)</u>  |  | <u>(1,474,330)</u>                            |                             |                                    |
|                                    | \$ =====  |  | \$ =====                                      |                             |                                    |

<sup>25</sup> The \$500,000 increase in cash flows expected to be collected results in a reclassification of nonaccretable difference to accretable yield.

|             | <i>Debt<br/>Security</i> | <i>Allowance</i> | <i>Debt<br/>Security</i> | <i>Loss</i> | <i>Cash</i>   | <i>Interest<br/>Income</i> <sup>26</sup> |
|-------------|--------------------------|------------------|--------------------------|-------------|---------------|--|
| Acquisition | \$4,000,000              |                  | \$4,000,000              |             | \$(4,000,000) |  |

**FSP FAS 115-2 and FAS 124-2**

|             |                   |                   |                   |                  |                  |
|-------------|-------------------|-------------------|-------------------|------------------|------------------|
| 20X1        |                   |                   |                   |                  |                  |
| collections | <u>(605,134)</u>  | <u>(605,134)</u>  |                   | 1,165,134        | \$560,000        |
| Balance     | 3,394,866         | 3,394,866         |                   |                  |                  |
| 20X2        |                   |                   |                   |                  |                  |
| collections | <u>(689,853)</u>  | <u>(689,853)</u>  |                   | 1,165,134        | 475,281          |
| Impairment  | <u>(232,163)</u>  | <u>(232,163)</u>  | \$232,163         |                  |                  |
| Balance     | 2,472,850         | 2,472,850         |                   |                  |                  |
| 20X3        |                   |                   |                   |                  |                  |
| collections | <u>(718,935)</u>  | <u>(718,935)</u>  |                   | 1,065,134        | 346,199          |
| Balance     | 1,753,915         | 1,753,915         |                   |                  |                  |
| 20X4        |                   |                   |                   |                  |                  |
| collections | <u>(756,481)</u>  | <u>(756,481)</u>  |                   | 1,315,134        | 558,653          |
| Balance     | 997,434           | 997,434           |                   |                  |                  |
| 20X5        |                   |                   |                   |                  |                  |
| collections | <u>(997,434)</u>  | <u>(997,434)</u>  |                   | <u>1,315,134</u> | <u>317,700</u>   |
|             | <u>          </u> | <u>          </u> | <u>          </u> | <u>2,025,670</u> | <u>2,257,833</u> |
|             | \$ =====          | \$ =====          | =====             | =====            | =====            |

<sup>26</sup> Because the loan is accounted for as a debt security, the reduction in cash flows expected to be collected at the end of 20X2 resulted in recognition in earnings of an other-than-temporary impairment that may not be reversed. The increase in the accretable yield is recognized as interest income on a prospective basis resulting in an increase in yield for years 20X4 and 20X5 from 14.00 percent to 31.8518 percent.

## **Appendix B**

### **FSP FAS 115-1 and FAS 124-1 as revised by this FSP and FSP FAS 107-1 and APB 28-1**

[This appendix is being provided for informational purposes only to show the amendments made to FSP FAS 115-1 and FAS 124-1 by this FSP and by FSP FAS 107-1 and APB 28-1 in context. The effective date and transition guidance in paragraph 19 and Appendix B of FSP FAS 115-1 and FAS 124-1 has not been included].

#### **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.

3A. FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, amends the recognition, presentation, and disclosure guidance in this FSP.

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*. Throughout this standard, the term *earnings* shall be replaced with *performance indicator*, and *other comprehensive income* shall be replaced with *outside the performance indicator* for debt securities that are within the scope of Statement 124.
  - 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").

#### **FASB STAFF POSITION**

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").<sup>1</sup> An investment is impaired if the fair value of the investment is less than its cost.<sup>2</sup> 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 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,<sup>3</sup> the investor shall evaluate whether an event or change

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<sup>1</sup> Individual 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.)

<sup>2</sup> Amortized cost basis includes adjustments made to the cost basis of an investment for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized in earnings (less any cumulative effect adjustments recognized in accordance with the transition provisions of FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*), and hedging fair value hedge accounting adjustments.

<sup>3</sup> 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 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

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.

### **Step 2: Evaluate Whether an Impairment Is Other Than Temporary**

13. When the fair value of an investment is less than its amortized cost basis at the balance sheet date of the reporting period for which impairment is assessed, the impairment is either temporary or other than temporary.<sup>4</sup> In addition to the guidance in this FSP, 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

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the fair value of the investment; ~~or~~ (eb) 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; or (c) the investor is exempt from providing the disclosure for interim reporting periods because the investor does not meet the definition of a publicly traded company, as defined by APB Opinion No. 28, *Interim Financial Reporting*.

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 Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets."

### **Equity Securities**

13A. For equity securities, an investor shall apply guidance that is pertinent to the determination of whether an impairment is other than temporary, such as SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*, and other authoritative literature.

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.

### **Debt Securities**

14A. If an investor intends to sell the debt security (that is, it has decided to sell the security), an other-than-temporary impairment shall be considered to have occurred.

14B. If an investor does not intend to sell the debt security, the investor shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before a forecasted recovery occurs). If the investor more likely than not will be required to sell the security before recovery of its amortized cost basis, an other-than-temporary impairment shall be considered to have occurred.

14C. If an investor does not expect to recover the entire amortized cost basis of the security, the investor would be unable to assert that it will recover its amortized cost basis even if it does not intend to sell the security. Therefore, in those situations, an other-than-temporary impairment shall be considered to have occurred. In assessing whether the entire amortized cost basis of the security will be recovered, an investor shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis of the

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<sup>4</sup> Other than temporary does not mean permanent.

security, the entire amortized cost basis of the security will not be recovered (that is, a credit loss exists), and an other-than-temporary impairment shall be considered to have occurred.

14D. In determining whether a credit loss exists, an investor shall use its best estimate of the present value of cash flows expected to be collected from the debt security. One way of estimating that amount would be to consider the methodology described in paragraphs 12–16 of FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, for measuring an impairment on the basis of the present value of expected future cash flows. Paragraph 14 of Statement 114 provides guidance on this calculation. Briefly, the investor would discount the expected cash flows at the effective interest rate implicit in the security at the date of acquisition.

14E. For debt securities that are beneficial interests in securitized financial assets within the scope of Issue 99-20, an investor shall determine the present value of cash flows expected to be collected by considering the guidance in paragraph 12(b) of Issue 99-20 for determining whether there has been a decrease in cash flows expected to be collected from cash flows previously projected. In other words, the cash flows estimated at the current financial reporting date shall be discounted at a rate equal to the current yield used to accrete the beneficial interest. Additionally, for debt securities accounted for in accordance with AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, an investor shall consider that standard in estimating the present value of cash flows expected to be collected from the debt security. A decrease in cash flows expected to be collected on an asset-backed security that results from an increase in prepayments on the underlying assets shall be considered in the estimate of the present value of cash flows expected to be collected.

14F. There are numerous factors to be considered when estimating whether a credit loss exists and the period over which the debt security is expected to recover. The following are a few examples of the factors that shall be considered. This list is not meant to be all inclusive.

- a. The length of time and the extent to which the fair value has been less than the amortized cost basis
- b. Adverse conditions specifically related to the security, an industry, or geographic area (for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed debt security, in the financial condition of the underlying loan obligors, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security or changes in the quality of the credit enhancement)
- c. The historical and implied volatility of the fair value of the security
- d. The payment structure of the debt security (for example, nontraditional loan terms as described in FSP SOP 94-6-1, *Terms of Loan Products That May Give Rise to a Concentration of Credit Risk*) and the likelihood of the issuer being able to make payments that increase in the future
- e. Failure of the issuer of the security to make scheduled interest or principal payments
- f. Any changes to the rating of the security by a rating agency
- g. Recoveries or additional declines in fair value subsequent to the balance sheet date.

14G. In making its other-than-temporary impairment assessment, an investor shall consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of cash flows expected to be collected. That information generally should include the remaining payment terms of the security, prepayment speeds, the financial condition of the issuer(s), expected defaults, and the value of any underlying collateral. To achieve that objective, the investor should consider, for example, industry analyst reports and forecasts, sector credit ratings, and other market data that are relevant to the collectibility of the security. An investor also should consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract as discussed in paragraph 8) and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by nontraditional loans). Thus, an investor should consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including “balloon” payments). An investor also should consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, an investor needs to assess the effect of that decline on the ability of the investor to collect the balloon payment.

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

**Equity Securities—If the Impairment Is Other Than Temporary, Recognize an Impairment Loss Equal to the Difference between the Investment’s Cost Basis 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.

**Debt Securities—Determination of the Amount of an Other-Than-Temporary Impairment Recognized in Earnings and Other Comprehensive Income**

15A. When an other-than-temporary impairment has occurred, the amount of the other-than-temporary impairment recognized in earnings depends on whether an investor intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss.

15B. If an investor intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be recognized in earnings equal to the entire difference between the investment's cost and its fair value at the balance sheet date. In assessing whether the investor more likely than not will be required to sell the security before recovery of its amortized cost basis less any current-period credit losses, the investor shall consider the factors in paragraph 14F.

15C. If an investor does not intend to sell the security and it is not more likely than not that the investor will be required to sell the security before recovery of its amortized cost basis less any current-period credit loss, the other-than-temporary impairment shall be separated into the following:

- a. The amount representing the credit loss
- b. The amount related to all other factors.

15D. The amount of the total other-than-temporary impairment related to the credit loss shall be recognized in earnings. The amount of the total other-than-temporary impairment related to other factors shall be recognized in other comprehensive income, net of applicable taxes.

15E. The previous amortized cost basis less the other-than-temporary impairment recognized in earnings shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in fair value. However, the amortized cost basis shall be adjusted for accretion and amortization as prescribed in paragraph 16.

## **ACCOUNTING FOR DEBT SECURITIES ~~SUBSEQUENT TO~~AFTER AN OTHER-THAN-TEMPORARY IMPAIRMENT**

16. In periods ~~subsequent to~~after the recognition of an other-than-temporary impairment loss for debt securities,<sup>5</sup> 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 at an amortized cost basis equal to the previous amortized cost basis less the other-than-temporary impairment recognized in earnings. 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.For debt securities for which other-than-temporary impairments were recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted in accordance with existing applicable guidance as interest income. An investor shall continue to estimate the present value of cash flows expected to be collected over the life of the debt security. For debt securities accounted for in

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<sup>5</sup> This 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.

accordance with Issue 99-20, an investor should look to that standard to account for changes in cash flows expected to be collected. For all other debt securities, if upon subsequent evaluation, there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, such changes shall be accounted for as a prospective adjustment to the accretable yield in accordance with SOP 03-3 even if the debt security would not otherwise be within the scope of that standard. Subsequent increases and decreases (if not an other-than-temporary impairment) in the fair value of available-for-sale securities shall be included in other comprehensive income.

16A. The other-than-temporary impairment recognized in other comprehensive income for debt securities classified as held-to-maturity shall be accreted from other comprehensive income to the amortized cost of the debt security over the remaining life of the debt security in a prospective manner on the basis of the amount and timing of future estimated cash flows. That accretion shall increase the carrying value of the security and shall continue until the security is sold, the security matures, or there is an additional other-than-temporary impairment that is recognized in earnings. If the security is sold, paragraphs 8 and 11 of Statement 115 provide guidance on the effect of changes in circumstances that would not call into question the investor's intent to hold other debt securities to maturity in the future.

## **PRESENTATION**

16B. In periods in which an investor determines that a security's decline in fair value below its amortized cost basis is other than temporary, the investor shall present the total other-than-temporary impairment in the statement of earnings with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income, in accordance with paragraph 15D, if any. The following is an example of the presentation on the face of the statement of earnings:

|  |                   |
|--|-------------------|
| <u>Total other-than-temporary impairment losses</u>                            | <u>(\$10,000)</u> |
| <u>Portion of loss recognized in other comprehensive income (before taxes)</u> | <u>4,000</u>      |
| <u>Net impairment losses recognized in earnings</u>                            | <u>(\$ 6,000)</u> |

16C. An investor also shall separately present, in the financial statement where the components of accumulated other comprehensive income are reported, amounts recognized therein related to held-to-maturity and available-for-sale debt securities for which a portion of an other-than-temporary impairment has been recognized in earnings.

## **DISCLOSURES**

17. For all investments in an unrealized loss<sup>6</sup> position, including those that fall within the scope of Issue 99-20, for which other-than-temporary impairments have not been recognized in earnings, an investor shall disclose the following in its interim and annual financial statements (included in this disclosure are investments for which a portion of an other-than-temporary impairment has been recognized in other comprehensive income):

- 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~~ major security type 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 amortized cost basis 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 the total amount by which amortized cost basis exceeds fair value as an other-than-temporary impairment in earnings or (b) the investor becoming aware of a recovery of fair value up to (or beyond) the amortized cost basis of the investment during the period.

- 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

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

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, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan to collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, 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 interim and 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 annual fair values under FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*, or

(3) The investor is exempt from estimating interim fair values because it does not meet the definition of a publicly traded company, as defined by APB Opinion No. 28, *Interim Financial Reporting*.

18A. For interim and annual periods in which an other-than-temporary impairment of a debt security is recognized and only the amount related to a credit loss was recognized in earnings, an investor shall disclose, by major security type, the methodology and significant inputs used to measure the amount related to the credit loss. Examples of significant inputs include, but are not limited to, performance indicators of the underlying assets in the security (including default rates, delinquency rates, and percentage of nonperforming assets), loan to collateral value ratios, third-party guarantees, current levels of subordination, vintage, geographic concentration, and credit ratings.

18B. For each interim and annual reporting period presented, an investor shall disclose a tabular rollforward of the amount related to credit losses recognized in earnings in accordance with paragraph 15D, which shall include at a minimum:

- a. The beginning balance of the amount related to credit losses on debt securities held by the investor at the beginning of the period for which a portion of an other-than-temporary impairment was recognized in other comprehensive income
- b. Additions for the amount related to the credit loss for which an other-than-temporary impairment was not previously recognized
- c. Reductions for securities sold during the period (realized)
- d. Reductions for securities for which the amount previously recognized in other comprehensive income was recognized in earnings because the investor intends to sell the security or more likely than not will be required to sell the security before recovery of its cost basis
- e. Additional increases to the amount related to the credit loss for which an other-than-temporary impairment was previously recognized when the investor does not intend to sell the security and it is not more likely than not that the investor will be required to sell the security before recovery of its cost basis
- f. Reductions for increases in cash flows expected to be collected that are recognized over the remaining life of the security (refer to paragraph 16)
- g. The ending balance of the amount related to credit losses on debt securities held by the entity at the end of the period for which a portion of

an other-than-temporary impairment was recognized in other comprehensive income.

**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.

| <u>Description of Securities</u>   | <u>Less Than<br/>12 Months</u> |                              | <u>12 Months<br/>or Greater</u> |                              | <u>Total</u>          |                              |
|--|--------------------------------|------------------------------|---------------------------------|------------------------------|-----------------------|------------------------------|
|  | <u>Fair<br/>Value</u>          | <u>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u>           | <u>Unrealized<br/>Losses</u> | <u>Fair<br/>Value</u> | <u>Unrealized<br/>Losses</u> |
| 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  | <u>\$ 753</u>                  | <u>\$23</u>                  | <u>\$ 76</u>                    | <u>\$ 2</u>                  | <u>\$ 829</u>         | <u>\$ 25</u>                 |

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 bases of the investments. Because the Company has the ability and intent to hold those investments until a recovery of fair value does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, 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 bases of the Company's investments. 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~~ does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, 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 basis 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 Manufacturing Company to settle the debentures would not be settled at a price less than the amortized cost basis of the investment (that is, the Company expects to recover the entire amortized cost basis of the security). Because the Company ~~has the ability and intent to hold this investment until a recovery of fair value~~ does not intend to sell the investment and it is not more likely than not that the Company will be required to sell the investment before recovery of its amortized cost basis, 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.