



## Alert

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## Changes in Impairment Accounting for Some Financial Instruments

Companies must recognize other-than-temporary impairments of beneficial interests in securitized financial assets within the scope of EITF 99-20 if current information and events indicate it is “probable” that there has been an adverse change in the instrument’s estimated cash flows, according to a newly issued FASB Staff Position, which also requires interest income for such beneficial interests to be based on the same cash flow estimate.<sup>1</sup> The Staff Position must be applied prospectively in interim and annual reporting periods ending after December 15, 2008 (in the fourth quarter of 2008 for public companies with a calendar year-end).

The Staff Position amends EITF 99-20. A key objective was to make EITF 99-20’s impairment model more consistent with Statement 115’s.<sup>2</sup> The Staff Position achieves this by amending the impairment model in EITF 99-20 to remove its exclusive reliance on “market participant” estimates of future cash flows used in determining fair value. Changing the cash flows used to analyze other-than-temporary impairment from the “market participant” view to a holder’s estimate of whether there has been a “probable” adverse change in estimated cash flows allows management to apply reasonable judgment in assessing whether an other-than-temporary impairment has occurred.

Because the decision under the new Staff Position on whether there has been an adverse change in the instrument’s estimated cash flows that reduces the financial instrument’s fair value below its carrying amount is to be based on the holder’s estimate of the cash flows, the Staff Position provides the following guidance on determining estimated cash flows:

- Companies should consider all available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts. This information generally should include the instrument’s remaining

<sup>1</sup> FASB Staff Position EITF 99-20-1, Amendments to the Impairment Guidance of EITF Issue No. 99-20, and EITF Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, both available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, available at [www.fasb.org](http://www.fasb.org).



**This is a publication of KPMG's  
Department of Professional  
Practice—Audit  
212-909-5600**

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payment terms, prepayment speeds, the issuer's financial condition, expected defaults, and the value of any underlying collateral.

- It is inappropriate for a company to automatically conclude that a security is not other-than-temporarily impaired because all of the scheduled payments to date have been received or to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Companies must exercise judgment when assessing whether declines in fair value indicate that it is probable that the company will not collect all of the contractual or estimated cash flows from the security. For example, the longer and/or the more severe the decline in fair value of a security, the more persuasive the evidence must be to overcome the premise that it is probable that the company will not collect all of the contractual or estimated cash flows from the issuer of the security.

The Staff Position is an interim step to address inconsistencies in current impairment models and achieve more consistent determinations of other-than-temporary impairments of debt securities classified as available-for-sale and held-to-maturity. The comprehensive joint FASB-IASB project on recognizing and measuring financial instruments will address the long-term solution.

Readers of the Staff Position are reminded that the objective of an other-than-temporary-impairment analysis is to determine whether it is probable that the holder will realize some portion of the unrealized loss on an impaired security. The holder may realize the unrealized loss on the impaired security if, for example, it is probable that the holder will not collect all the contractual or estimated cash flows after considering both their timing and amount or the holder lacks the intent and ability to hold the security to recovery. The Staff Position also highlights the existing accounting and disclosure requirements in Statement 115 and other related guidance, including guidance on determining whether an impairment on financial instruments within the scope of Statement 115 and EITF 99-20 is other-than-temporary and that any other-than-temporary impairment recognized is to be measured by the difference between the investment's cost and its fair value at the balance-sheet date.<sup>3</sup>

**Effective Date.** The new requirements are effective for interim and annual reporting periods ending after December 15, 2008. The requirements are effective for the interim (fourth-quarter) and annual financial statements of calendar-year-end companies as of December 31, 2008. Retrospective application to a prior interim or annual reporting period is prohibited, which means other-than-temporary impairments recognized in periods before the effective date of this amendment cannot be reversed (for example, other-than-temporary impairments recognized in the second or third quarter of 2008 for a calendar-year-end-company).

The descriptive and summary statements in this newsletter are not intended to be a substitute for the Staff Position or any other applicable or potential accounting literature or SEC regulations. Companies applying GAAP or filing with the SEC should apply the texts of the relevant laws, regulations, and accounting requirements, consider their particular circumstances, and consult their accounting and legal advisors.

<sup>3</sup> FASB Staff Position FAS 115-1 and 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, available at [www.fasb.org](http://www.fasb.org), and SEC Staff Accounting Bulletins Topic 5M, Other than Temporary Impairment of Certain Investments in Debt and Equity Securities, available at [www.sec.gov](http://www.sec.gov).