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Audit and Enterprise Risk Services

The Impact of the Emergency Economic Stabilization Act on the Assessment of Other-Than-Temporary Impairments

Financial Reporting Alert 08-15

October 13, 2008

Background

President Bush signed the Emergency Economic Stabilization Act of 2008 (the "Act") into law on October 3, 2008. The Act grants the secretary of the Treasury authority to purchase debt securities from financial institutions. A question has been raised regarding whether, for reporting periods that ended before October 3, 2008, the Act affects an entity's assertion that it has the intent to hold impaired securities until forecasted recovery in determining whether the impairments are other-than-temporary.

Summary

As discussed below, the enactment of the Act on October 3, 2008, may not affect an entity's assessment, as of a prior reporting date, of its intent to hold an impaired security until forecasted recovery. Regardless of its conclusions about the Act, an entity must still perform its customary periodic other-than-temporary impairment (OTTI) analysis as of the reporting date. Furthermore, to determine that an impairment is not other-than-temporary, an entity must still assess, as of its reporting date, whether it has the intent and ability to hold an impaired security until forecasted recovery.

For securities that are classified as held-to-maturity or available-for-sale pursuant to Statement 115,[1] or that are subject to Opinion 18,[2] an entity must assess, as of each reporting date, whether any impairments (i.e., fair value is less than amortized cost) are other-than-temporary. For an impairment not to be deemed other-than-temporary as of a reporting date, an entity must be able to assert that it has both the intent and the ability to hold the underwater security until

forecasted recovery.[3] The Act does not affect the entity's ability to hold a security until forecasted recovery. The issue is whether an entity's consideration of the Act (i.e., whether it will avail itself of the relief measures and sell securities to the U.S. government pursuant to the Act) affects its assertion that it had the intent to hold an impaired security until its forecasted recovery as of a reporting date that preceded October 3, 2008.

Typically, events that occur between the reporting date and the date an entity's financial statements are issued (e.g., if the entity sells an underwater security at a loss after the reporting date) should be considered in evaluating an entity's intent, as of the reporting date, to hold a security until its forecasted recovery. An event that occurs after the reporting date requires consideration of whether this intent is supportable. A substantive change in facts and circumstances associated with the security after the reporting date may support a change in the entity's intent after the reporting date.

The Act constitutes such a change in circumstances. It would be reasonable for an entity to assess its intent to hold a security until recovery as of a reporting date before October 3, 2008, on the basis of the facts and circumstances that existed as of that date, which do not include the Act since the Act's final provisions were not known. An entity's reassessment of its intent to hold a security until recovery on the basis of the final provisions of the Act would be a change in the entity's assertion for periods including October 3, 2008. Accordingly, an entity may perform its OTTI assessment for any reporting periods that ended before October 3, 2008, in the absence of consideration of the Act (i.e., in the absence of a change in the entity's assertion of its intent that resulted from the Act).

In documenting its OTTI analyses for reporting periods that ended before October 3, 2008, an entity should highlight that the Act was a significant change in circumstances that occurred after the reporting date and has not been considered in the entity's assessment of OTTI as of the balance sheet date. The entity also should disclose in its MD&A any anticipated impact of the Act on its future financial position, results of operations, cash flows, or liquidity.

Editor's Note: In assessing whether to continue to classify a security as held-to-maturity, an entity must consider its intent and ability to hold the security until maturity. In a manner similar to the OTTI assessment discussed above, it would be reasonable for an entity to assess its intent to hold a security to maturity as of a reporting date that ended before October 3, 2008, on the basis of the facts and circumstances that existed as of that date, which do not include a consideration of the Act.

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

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

3 This Alert focuses on an entity's intent and ability to hold a security until its forecasted recovery in determining whether a security is other-than-temporarily impaired. It does not address situations in which a security may be deemed other-than-temporarily impaired (e.g., as a result of a credit concern), regardless of the entity's intent and ability to continue to hold the security.

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