

achieved by reconstructing the base year cost of new items added to existing pools." In ASR 293, the Commission stated that when the effects of inflation on the cost of new products are measured by making a comparison with current cost as the base-year cost, rather than a reconstructed base-year cost, income is improperly increased.

**Question 2:** If a registrant utilizes a LIFO practice other than one recommended by an advisory conclusion in the issues paper, must the registrant change its practice to one specified in the paper?

**Interpretive Response:** Now that the issues paper is available, the staff believes that a registrant and its independent accountants should re-examine previously adopted LIFO practices and compare them to the recommendations in the paper. In the event that the registrant and its independent accountants conclude that the registrant's LIFO practices are preferable in the circumstances, they should be prepared to justify their position in the event that a question is raised by the staff.

**Question 3:** If a registrant elects to change its LIFO practices to be consistent with the guidance in the issues paper and discloses such changes in accordance with APB Opinion 20 will the registrant be requested by the staff to explain its past practices and its justification for those practices?

**Interpretive Response:** The staff does not expect to routinely raise questions about changes in LIFO practices which are made to make a company's accounting consistent with the recommendations in the issues paper.

#### *M. Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*

**Facts:** Paragraph 16 of Statement 115 specifies that "[f]or 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 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)."

Statement 115 does not define the phrase "other than temporary." In applying this guidance to its own situation, Company A has interpreted "other than temporary" to mean permanent impairment. Therefore, because Company A's management has not been able to determine that its

investment in Company B is permanently impaired, no realized loss has been recognized even though the market price of B's shares is currently less than one-third of A's average acquisition price.

**Question:** Does the staff believe that the phrase "other than temporary" should be interpreted to mean "permanent"?

**Interpretive Response:** No. The staff believes that the FASB consciously chose the phrase "other than temporary" because it did not intend that the test be "permanent impairment," as has been used elsewhere in accounting practice.<sup>1</sup>

The value of investments in marketable securities classified as either available-for-sale or held-to-maturity may decline for various reasons. The market price may be affected by general market conditions which reflect prospects for the economy as a whole or by specific information pertaining to an industry or an individual company. Such declines require further investigation by management. Acting upon the premise that a write-down may be required, management should consider all available evidence to evaluate the realizable value of its investment.

There are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case. The staff believes that the following are only a few examples of the factors which, individually or in combination, indicate that a decline is other than temporary and that a write-down of the carrying value is required:

- a. The length of the time and the extent to which the market value has been less than cost;
- b. The financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; or
- c. The intent and ability of the holder to retain its investment in the issuer for

<sup>1</sup>Footnote 4 to Statement 115 refers to this SAB for a discussion of considerations applicable to a determination as to whether a decline in market value below cost, at a particular point in time, is other than temporary. FASB's implementation guide "A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities," SAS 92, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities," AICPA Audit Guide, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities," and EITF Topic D-44 also address issues related to the determination of whether a decline in fair value of an investment security is other than temporary.

a period of time sufficient to allow for any anticipated recovery in market value.

Unless evidence exists to support a realizable value equal to or greater than the carrying value of the investment, a write-down to fair value accounted for as a realized loss should be recorded. In accordance with the guidance of paragraph 16 of Statement 115, such loss should be recognized in the determination of net income of the period in which it occurs and the written down value of the investment in the company becomes the new cost basis of the investment.

#### *N. Discounting by Property-Casualty Insurance Companies*

**Facts:** A registrant which is an insurance company discounts certain unpaid claims liabilities related to short-duration<sup>1</sup> insurance contracts for purposes of reporting to state regulatory authorities, using discount rates permitted or prescribed by those authorities ("statutory rates") which approximate 3½ percent. The registrant follows the same practice in preparing its financial statements in accordance with GAAP. It proposes to change for GAAP purposes, to using a discount rate related to the historical yield on its investment portfolio ("investment related rate") which is represented to approximate 7 percent, and to account for the change as a change in accounting estimate, applying the investment related rate to claims settled in the current and subsequent years while the statutory rate would continue to be applied to claims settled in all prior years.

**Question 1:** What is the staff's position with respect to discounting claims liabilities related to short-duration insurance contracts?

**Interpretive Response:** The staff is aware of efforts by the accounting profession to assess the circumstances under which discounting may be appropriate in financial statements. Pending authoritative guidance resulting from those efforts however, the staff will raise no objection if a registrant follows a policy for GAAP reporting purposes of:

- Discounting liabilities for unpaid claims and claim adjustment expenses at the same rates that it uses for reporting to state regulatory authorities with respect to the same claims liabilities, or

<sup>1</sup> The term "short-duration" refers to the period of coverage (see statement 60, paragraph 7), not the period that the liabilities are expected to be outstanding.