Case 14-09
O.T.T. Incorporated
Financial Instruments — Other-Than-Temporary Impairment

O.T.T. Incorporated ("the Company" or "OTT"), incorporated in Delaware, is principally engaged in the manufacture and sale of clothing. The Company has three lines of business: (1) outerwear, (2) t-shirts, and (3) tank tops. OTT was extremely successful in its early years when it partnered with colleges and universities to create outerwear, t-shirts, and tank tops for athletes, students, and alumni. This partnership also enabled OTT to hire a group of college graduates with a proven track record and a passion for investing in the stock market. Together, OTT and these graduates created a new investment department in 20X1. OTT management set aside a portion of the previous years' profits for the investment department to invest in equity and debt securities for the Company. OTT has six investments remaining in the department's portfolio as of December 31, 20X1. OTT classified all equity and debt securities as either available for sale or held to maturity under the Company's investment policy.

The accounting department is preparing financial statements for the fiscal year ended December 31, 20X1, and the auditors have asked OTT whether any of its investments are other-than-temporarily impaired. The CFO of OTT needs to present the investment department's financial results at the next operating committee meeting so the committee can decide whether to continue the investment program and if so, determine the amount of funds that should be allocated. In looking at the accounting records provided by the accounting department, the CFO is beginning to question the investment department's expertise because all investments have declined in value relative to each investment's original purchase price.

The accounting manager compiled the following information about each of the investments in order to determine whether the investment is other-than-temporarily impaired as of December 31, 20X1.

- OTT purchased 11 shares of Happy New Year & Co. stock on January 3, 20X1, at $20 a share to celebrate the new year and classified its investment as available for sale. In March, the share price dropped to $15, and from April through November the price remained steady between $14.75 and $15.25 per share. On December 31, 20X1, the price was $15. OTT management does not believe the decline in price to be permanent and has asserted that it does not intend to sell this investment in the future.
- On November 11, 20X1, OTT purchased notes of Beary Beary. As of December 31, 20X1, the amortized cost of the debt security is $95 and the fair value is $88. Although OTT's investment committee established a policy requiring the sale of this security when the fair value declines below $90, OTT still held the investment on December 31, 20X1.
- On September 20, 20X1, OTT purchased bonds issued by Buy-A-Lot Company with an amortized cost of $100 and a fair value of $88 as of December 31, 20X1. In December, S&P upgraded the credit rating of Buy-A-Lot Company from BBB

to BBB+. Management has asserted it does not intend to sell this investment in the future.

- On March 25, 20X1, OTT bought 50 shares of March Madness Incorporated stock at $100 a share, classifying its investment as available for sale. In August, the price of the stock decreased to $70, and from September through November, the stock price fluctuated between $65 and $75. As of December 31, 20X1, the price of the stock was $72. On January 31, 20X2, the date the Company's financial statements are issued, the price of the stock went up to $75.
- OTT purchased bonds issued by Tohoku Toys on February 9, 20X1. The bonds have an amortized cost of $25 and a fair value of $5 as of December 31, 20X1. Tohoku Toys is going through a restructuring because it was significantly affected by a severe earthquake in April 20X1. OTT does not believe that the restructuring will ultimately be successful.
- OTT holds a debt security issued by Chatterbox with an amortized cost of $100 and a fair value of $90 as of December 31, 20X1. The present value of the cash flows OTT expects to receive, taking into consideration the credit quality of Chatterbox, discounted at the security's original effective interest rate is $92 as of December 31, 20X1. OTT intends to sell this security.

Required:

1. For the following investments, determine if OTT should record an other-than-temporary impairment as of December 31, 20X1, and if so, for what amount:
   - Happy New Year & Co.
   - Beary Beary.
   - Buy-A-Lot Company.

2. Assuming OTT has determined its investment in March Madness Incorporated stock is other-than-temporarily impaired, how much should be recorded as an impairment charge as of December 31, 20X1?
3. Assume the same facts as in 2 above, but that OTT has not yet determined whether an impairment exists or the amount of any possible impairment. For March Madness Incorporated, would OTT still conclude that the investment is other-than-temporarily impaired, and would the impairment charge as of December 31, 20X1, be different if the stock price at issuance of the financial statements (i.e., as of January 31, 20X2) was $95 and not $75?
4. For Tohoku Toys, determine if OTT should record an other-than-temporary impairment as of December 31, 20X1.
5. For Chatterbox, what amount should be recorded as the other-than-temporary impairment as of December 31, 20X1? Does the answer change if OTT does not intend to sell the security and it is not more likely than not that it will be required to sell the security?