

## NAREIT's Accounting & Financial Standards Hot Topics



# SFO Alert

March 5, 2013

## FASB Proposes Revised Classification and Measurement Model for Financial Instruments

On February 14, the Financial Accounting Standards Board (FASB or the Board) issued a proposed model (the [Proposal](#)) for the classification and measurement of financial instruments. Both equity and mortgage REITs that report financial assets and/or financial liabilities would be impacted by the Proposal, as the proposed model would apply to entities across industries with few exceptions. If you are interested in participating in NAREIT's task force that will evaluate the Proposal and consider whether NAREIT should submit a comment letter, please contact Christopher Drula at [cdrula@nareit.com](mailto:cdrula@nareit.com) by March 15, 2013. Comments are due to the FASB by May 15.

### Debt Investments

Under the Proposal, classification and measurement of a financial asset would be based on the asset's cash flow characteristics and the entity's business model for managing the financial asset. This would represent a fundamental change from the current model, which is based on the legal form of the financial asset (*i.e.*, a loan versus a security). Based on the cash flow characteristics and business model assessments, financial assets would be classified into one of three categories:

- Amortized cost – financial assets with solely payments of principal and interest that are held for the collection of contractual cash flows
- Fair value through other comprehensive income (OCI) – financial assets with solely payments of principal and interest that are both held for the collection of contractual cash flows and for sale
- Fair value through net income – financial assets that do not qualify for measurement at either amortized cost or fair value through other comprehensive income

### Equity Investments

Under the Proposal, all equity investments (*e.g.*, investments in common or preferred stock), with the exception of investments accounted for under the equity method, would be measured at fair value with changes in fair value recognized in net income. This classification conclusion would be based on the fact that equity investments do not have payments of principal and interest.

### Financial Liabilities

Under the Proposal, financial liabilities (*e.g.*, non-recourse debt) would generally be measured at amortized cost unless the entity's business model is to subsequently execute transactions based on the financial liabilities' fair value (*e.g.*, short sales).

### Replacement of the Unconditional Fair Value Option with Limited Conditional Fair Value Options

The Proposal would replace the unconditional fair value option under current U.S. GAAP with limited fair value options. The fair value option under the Proposal would be limited to:

- A group of financial assets and financial liabilities if the entity both:
  - Manages the net exposure relating to those financial assets and financial liabilities (which may be derivative instruments) on a fair value basis and
  - Provides information on that basis to the reporting entity's management.
- Hybrid financial liabilities that meet certain prescribed criteria.
- Financial assets that meet the proposed contractual cash flow characteristics criterion and are managed within a business model that has the objective of both holding financial assets to collect contractual cash flows and selling financial assets.

### Presentation and Disclosure

For financial instruments measured at amortized cost by public companies, the Proposal would require parenthetical disclosure of fair value on the face of the balance sheet. The only financial instruments excluded from this requirement would be financial instruments with terms one year or less. Private companies would be excluded from these presentation and disclosure requirements.

If you have any questions, please contact George Yungmann at [gyungmann@nareit.com](mailto:gyungmann@nareit.com) or Chris Drula at [cdrula@nareit.com](mailto:cdrula@nareit.com).



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