

# Technical Line

## Financial reporting considerations for commercial real estate entities and their lenders

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### What you need to know

- ▶ Real estate entities and their lenders need to consider the accounting and financial reporting implications of macroeconomic factors, such as higher interest rates and tighter lending standards, and industry trends, such as declines in cash flows or occupancy for certain properties.
- ▶ The effects may be direct or indirect, depending on the company and subsector.
- ▶ Management should carefully evaluate the effects on estimates and other assumptions used in preparing the financial statements.
- ▶ Entities will need to closely monitor developments and assess the implications for their business and their internal control over financial reporting (i.e., entities may need to identify new controls or modify existing controls).

### Overview

Entities that own or operate commercial real estate or lend money to the industry need to consider how their accounting and financial reporting may be affected by macroeconomic factors, such as the increased cost of capital and tighter lending standards, and industry trends, such as declining cash flows or occupancy for certain properties. Securities and Exchange Commission (SEC) registrants also need to make sure their risk factor disclosures and management's discussion and analysis (MD&A) address these trends.

All entities with ties to the commercial real estate industry need to consider the effect of higher interest rates on their ability to secure new loans or refinance existing loans, their property valuations, the cash flow projections they use in their prospective financial information, their

calculations of discount rates and their going concern evaluations. Over the past two years, the Federal Reserve has raised its benchmark federal-funds rate from near zero to more than 5%, a 22-year high.

Nearly \$1.5 trillion of US commercial real estate debt is scheduled to come due before the end of 2025.<sup>1</sup> At the same time, banks surveyed by the Federal Reserve said they tightened their lending standards in the second quarter of 2023 and expect to tighten them further.<sup>2</sup> Stricter lending standards could create challenges for real estate entities that are looking to secure new financing or refinance existing loans and could require them to provide cash collateral.

Changes in the consumer preferences about where they work, live, shop and eat have also impacted commercial real estate resulting in declines in occupancy, which has contributed to declines in property values, though not all commercial real estate has been impacted equally. On average, US commercial real estate property prices are down approximately 15% from their 2022 peak, according to Green Street.<sup>3</sup> When evaluating the possible accounting and reporting implications of these trends, real estate entities and lenders need to consider the type of commercial property (e.g., office, retail, residential, industrial, health care), the quality of the assets, conditions in the geographical region and other market dynamics. Accordingly, management will need to consider the entity's facts and circumstances and should consider any potential effects consistently when preparing financial statements.

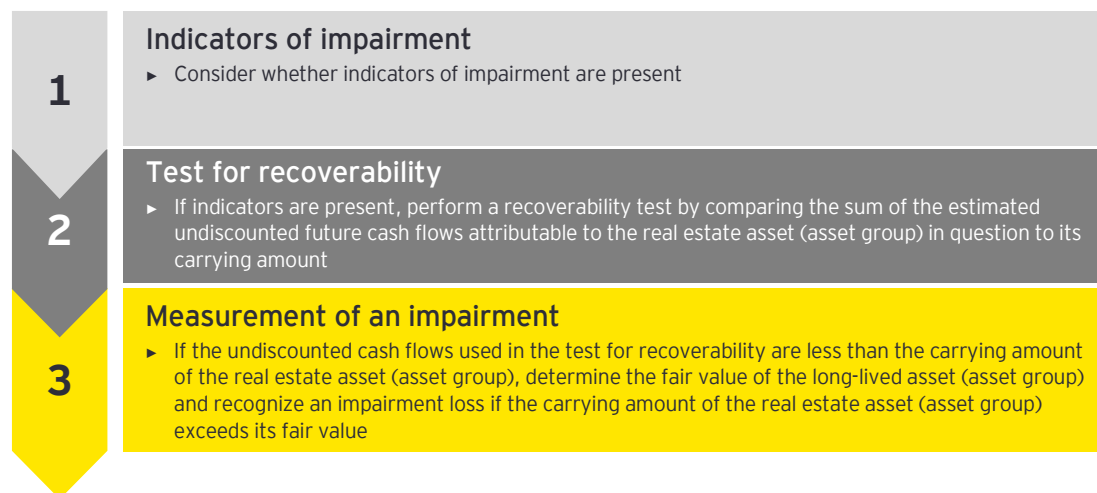
The Appendix lists EY publications that discuss these topics in more detail.

## Key considerations

### Asset impairments

#### *Impairment of real estate assets to be held and used*

The following are the required steps to identify, recognize and measure the impairment of a real estate asset or an asset group to be held and used:



Current macroeconomic and industry trends, such as the impact of rising interest rates, reductions in market prices of commercial real estate assets and lower occupancy rates, may be impairment indicators. Entities holding real estate that determine that impairment indicators exist will need to consider the effects of these trends on their projections of undiscounted cash flows for the real estate asset (asset group) being evaluated for recoverability (Step 2 recoverability test).

Current trends, such as the decline in the value of real estate assets and lower occupancy rates, may be impairment indicators.

Management's intent with regard to the real estate asset is an important factor to consider when estimating cash flows. For example, a building that is leased to tenants under operating leases (e.g., an office building or an apartment building) that has indicators of impairment (e.g., it is only 40% occupied) might have a remaining useful life of 20 years. If management intends to hold and operate a real estate asset over its remaining useful life, rental cash flows would be estimated over that term, and the estimated sales value of the building at the end of the period would be added to those amounts.

In many instances, real estate assets financed with a mortgage may require a balloon principal payment, which, when due, necessitates a refinancing or restructuring. In cases where the entity's ability to refinance or restructure is uncertain, management must evaluate what is the appropriate period to estimate cash flows (Step 2 recoverability test). In general, if management believes it is reasonably possible that the entity will be able to refinance or restructure the debt (e.g., the entity has recently refinanced similar projects, the asset has a sufficient loan-to-value ratio), using the asset's remaining useful life would be appropriate. Conversely, if management believes that it is probable that the entity will not be able to refinance or restructure the debt and that it is likely the property will have to be sold to satisfy the debt, the period used for the cash flow estimate would not extend beyond the maturity date of the debt. Additionally, entities need to consider the possibility of a reduction in cash flows due to lower market rents or declines in occupancy as a result of changes in supply of available real estate and demand for leased space. A probability-weighted approach may be useful in considering the likelihood of possible outcomes in order to determine the best estimate of future cash flows.

Entities that determine that the carrying amount is not recoverable based on the Step 2 undiscounted cash flows are required to determine the fair value of the real estate asset (asset group) (Step 3 impairment test). The fair value of the real estate asset (asset group) should consider its highest and best use from the perspective of market participants. Additionally, entities will need to consider the effect of higher interest rates on significant assumptions (e.g., discount rates, capitalization rates) used to determine the fair value of the real estate asset (asset group). Higher discount rates and capitalization rates could result in a lower fair value of a real estate asset (asset group) that may lead entities to recognize impairment losses (i.e., the carrying amount of the real estate asset (asset group) exceeds its fair value). Real estate assets may be financed with a mortgage, typically through nonrecourse debt. The existence of nonrecourse debt should not influence the measurement of fair value of real estate. The recognition of an impairment loss and the recognition of a gain on the extinguishment of debt are separate events, and each event should be recognized in the period in which it occurs.

Entities also need to consider the requirements for risk and uncertainty disclosures in Accounting Standards Codification (ASC) 275, *Risks and Uncertainties*, which apply to real estate assets whose value may become impaired in the near term (i.e., the estimates of future cash flows used in the recoverability test or to determine fair value may be particularly sensitive to change).

Refer to our Financial reporting developments (FRD) publication, [\*\*\*Impairment or disposal of long-lived assets\*\*\*](#), for additional information.

#### ***Real estate assets to be disposed of by sale***

A real estate asset (or disposal group) that an entity intends to dispose of by sale should be considered held for sale in the period when all of the criteria in ASC 360-10-45-9, *Property, Plant, and Equipment*, are met.

A real estate asset (disposal group) classified as held for sale is initially measured at the lower of its carrying amount or fair value less cost to sell (e.g., broker commissions, legal fees, title transfer fees, closing costs). A loss is recognized for any initial adjustment of the carrying amount of the real estate asset (disposal group) to its fair value less cost to sell in the period the held for sale criteria are met. The fair value less cost to sell of the real estate asset (disposal group) should be assessed each reporting period it remains classified as held for sale. A subsequent change in the real estate asset's fair value less cost to sell (increase or decrease) would be reported as an adjustment to its carrying amount, except that the adjusted carrying amount must not exceed the carrying amount of the real estate asset at the time it was initially classified as held for sale.

Refer to our FRD, [\*Impairment or disposal of long-lived assets\*](#), for more information.

#### ***Equity method investments***

Entities that have equity method investments in real estate (including investments in joint ventures) should consider whether declines in the fair value of these investments based on changes in the macroeconomic environment (e.g., higher interest rates, lower occupancy rates) represent changes in circumstances that indicate carrying amounts might not be recoverable. These circumstances can include, but are not limited to the following:

- ▶ Evidence that the investor does not have the ability to recover the carrying amount of the investment
- ▶ The inability of the investee to sustain earnings
- ▶ A current fair value of the investment that is less than the carrying amount
- ▶ Other investors ceasing to provide support or reduce their financial commitment to the investee

An investor also should consider whether its equity method investment might be impaired when an investee recognizes an impairment loss (which would, in turn, be reflected by the investor through its application of the equity method).

If there has been a significant decline in the fair value of an equity method investee, an investor would need to exercise judgment to determine whether the decline is other than temporary. When an investor has the intent and/or ability to recover the carrying amount of the investment over a long period (e.g., from cash flows from the investee), the investor still evaluates whether that recovery will occur in the near term. If the fair value of the investment is less than its carrying amount, and the investment will not recover in the near term, an other-than-temporary impairment may exist. ASC 820, *Fair Value Measurement*, provides the authoritative guidance for measuring fair value.

If an investor determines that an investment is other than temporarily impaired, the investment is recorded at its fair value (i.e., the impairment is measured as the difference between its carrying amount and fair value).

Refer to our FRD, [\*Equity method investments and joint ventures\*](#), for additional information.

#### ***Allowance for credit losses under ASC 326***

Lenders will need to consider current economic conditions in their assessment of the allowance for credit losses under ASC 326, *Financial Instruments – Credit Losses*, for various assets, including loans and net investments in both sales-type leases and direct financing leases.

If there has been a significant decline in the fair value of an equity method investee, an investor would need to exercise judgment to determine whether the decline is other than temporary.

### *Financing receivables*

Entities are required to consider reasonable and supportable forecasts of future economic conditions in the estimate of expected credit losses. Declines in occupancy rates will often increase the likelihood of borrowers taking a longer time to repay amounts outstanding or the probability of borrowers being unable to repay their obligations when due. This may be particularly true for lenders with collateral in certain asset classes (e.g., office buildings) and certain geographies (e.g., large metropolitan areas).

Lenders will also need to consider whether current economic conditions and uncertainty may cause financial assets previously pooled under ASC 326 to no longer exhibit similar risk characteristics (e.g., external credit ratings, risk ratings, collateral type). For these assets, entities need to assess whether the assets continue to display similar risk characteristics or whether they have to revise their pools or perform an individual assessment of expected credit losses. Lenders should consider highlighting these risk characteristics in their qualitative and quantitative disclosures about credit risk and the allowance for credit losses. They should also consider the disclosures related to the basis of inputs and assumptions and estimation techniques used, and how forward-looking information has been incorporated.

Affected lenders also may find it necessary to modify a borrower's payment terms (including providing a borrower with more time to pay its debt) if there has been significant deterioration in the borrower's liquidity.

Refer to our FRD, [\*\*\*Credit impairment under ASC 326\*\*\*](#), for a detailed discussion about extensions, renewals and modifications.

### *Net investment in leases*

Real estate lessors are required to evaluate their net investments in sales-type leases and direct financing leases for impairment. When determining the allowance for credit losses for a net investment in the lease, lessors should take into consideration the collateral relating to the net investment in the lease, including cash flows that the lessor expects to receive (or derive) from the lease receivable and the unguaranteed residual asset during both the remaining lease term and after it ends. The amount that the lessor expects to derive from the unguaranteed residual asset would be based on the expected value of the residual asset at the end of the lease term, less any amounts guaranteed by the lessee or any other third party unrelated to the lessor. The Financial Accounting Standards Board (FASB) staff has clarified that expected cash flows from the disposal of leased assets (including any gains and losses) should be included in the estimate of expected credit losses on net investments in leases.<sup>4</sup>

### *Collateralized financial assets*

Lenders that have collateralized financial assets (e.g., a loan secured by commercial real estate) should consider the potential for adverse changes in the value of the collateral over the remainder of the financial assets' expected lives (e.g., changes in the value of a specific commercial property or a broader commercial real estate index) based on historical loss experience for financial assets that were secured by similar collateral and reasonable and supportable forecasts of future economic conditions. ASC 326 generally does not permit an entity to assume a loss of zero on a financial asset that is secured by collateral simply because the current value of the collateral exceeds the amortized cost basis of the financial asset.

If foreclosure is probable, a commercial real estate lender is required to measure expected credit losses based on the difference between the current fair value of the collateral and the amortized cost basis of the financial asset. An entity should not delay recognition of the credit loss until actual foreclosure occurs, since a lender may take physical possession without actual foreclosure and passage of title.<sup>5</sup>

If the entity determines that foreclosure is not probable, the entity is permitted to apply a practical expedient and estimate expected credit losses on collateral-dependent financial assets using the difference between the collateral's fair value (less costs to sell the asset if repayment is expected through the sale of the collateral) and the amortized cost basis of the financial asset. An asset must meet both of the following criteria to be considered collateral dependent:

- ▶ The entity expects repayment of the financial asset to be provided substantially through the operation or sale of the collateral.
- ▶ The entity has determined that the borrower is experiencing financial difficulty as of the measurement date.

How an entity considers the fair value of the collateral when estimating expected credit losses depends on whether repayment of the financial asset is expected to be from the sale or the operation of the collateral. When repayment will be from the operation of the collateral (by the entity, the borrower or a third party), an entity would generally use the present value of expected cash flows from the operation of the collateral as the fair value (an income approach). When an entity expects to sell the collateral so the asset can be repaid, the entity should deduct the costs to sell from the fair value of the collateral measured as of the measurement date.

Refer to our FRD, [\*\*\*Credit impairment under ASC 326\*\*\*](#), for further discussion.

#### *Interest Income*

Lenders may need to consider the amount and timing of interest income recognized in the current environment. Lenders may apply nonaccrual policies and methods to mitigate the risk of overstating interest income when collection of that income is in doubt (e.g., when the value of collateral has deteriorated and repayment from the borrower is expected through the sale or operation of the collateral).

While US GAAP does not provide specific guidance for the application of nonaccrual methods, several approaches exist in practice, such as the cash basis method and the cost recovery method. The application of a nonaccrual policy, and the method used to account for any contractual interest payments that are collected while an asset is on nonaccrual status, has a direct effect not only on interest income but also on the amount of any future write-off.

The choice of a nonaccrual policy can significantly affect the amount and timing of write-offs and interest income recognized in addition to whether an entity is required to measure an allowance for credit losses on accrued interest. Lenders that elect to apply nonaccrual policies are required to describe their nonaccrual policies and disclose relevant quantitative information about nonaccruals.

Refer to our FRD, [\*\*\*Credit impairment under ASC 326\*\*\*](#), for more information on application of nonaccrual policies.

#### **Sales and transfers of real estate assets**

Market dynamics and liquidity concerns may lead entities holding real estate to consider selling or disposing of real estate assets. Entities need to carefully evaluate which derecognition guidance applies to such transactions, based on the facts and circumstances of the sale, partial sale or transfer of the real estate asset.

Refer to our FRD, [\*\*\*Gains and losses from the derecognition of nonfinancial assets \(ASC 610-20\)\*\*\*](#), for more information.

Real estate entities and their lenders will need to consider the effects of the current environment in their going concern evaluations.

### **Debt modifications and debt covenant violations**

The effects of the current lending environment, including increased interest rates and tightening of credit, may lead to liquidity issues for borrowers and debt covenant violations. An increase in interest rates or decline in the fair value of collateral may lead to the need for borrowers to amend the terms of existing debt agreements or obtain waivers if they no longer satisfy debt covenants.

Borrowers need to consider the guidance in ASC 470-50, *Debt – Modifications and Extinguishments*, and ASC 470-60, *Debt – Troubled Debt Restructurings by Debtors*, to determine whether a change to an existing debt arrangement represents a troubled debt restructuring, a debt modification or a debt extinguishment, each of which would have different accounting implications.

In addition, borrowers that present classified balance sheets need to consider the guidance in ASC 470-10 to determine whether they need to classify debt as a current liability if there has been a covenant violation or other default at the balance sheet date (or prior to the issuance of financial statements).

Refer to our FRDs, [\*Issuer's accounting for debt and equity financings \(before the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity\)\*](#) and [\*Issuer's accounting for debt and equity financings \(after the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity\)\*](#), for additional information.

### **Going concern**

Real estate entities and their lenders will need to consider the effects of the current environment in their going concern evaluations. For example, tighter lending standards may make it difficult for real estate entities to obtain capital or refinance debt, which could significantly affect an entity's operating cash flow and liquidity. Accordingly, management may need to update the cash flow projections it uses in its going concern evaluation.

ASC 205-40, *Presentation of Financial Statements – Going Concern*, requires management to evaluate whether there are conditions or events that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date the financial statements are issued (or available to be issued, when applicable). Disclosures in the notes to the financial statements are required if management concludes that substantial doubt exists or that its plans alleviate that substantial doubt. Management is required to make its evaluation and provide the relevant disclosures for both annual and interim reporting periods.

### **Derivatives and hedge accounting**

#### ***Fair value measurement of derivatives***

Entities that hold interest rate derivative instruments may experience substantial gains or losses, which could affect the amount of collateral they are required to provide and, therefore, their liquidity. In addition, changes in a derivative counterparty's credit risk or an entity's own nonperformance risk could affect fair value estimates of derivatives, as well as hedge effectiveness assessments for interest rate derivatives that are designated as hedging instruments.

#### ***Hedge accounting activity***

Entities looking to protect themselves from rising interest rates may enter into interest rate derivatives to hedge interest rate risk related to forecasted debt issuances or existing variable-rate debt. Entities need to make sure they satisfy the requirements in ASC 815, *Derivatives and Hedging*, to apply hedge accounting for these transactions.

It is also important to consider the appropriate classification of cash flows from derivative instruments on the statement of cash flows. Generally, cash flows from derivatives are classified according to their nature. However, if a derivative is designated as the hedging instrument in a cash flow or fair value hedge (and does not contain an other-than-insignificant financing element), the related cash flows may be classified in the same category as the cash flows from the items being hedged, as long as that accounting policy is disclosed. In addition, both ASC 230, *Statement of Cash Flows*, and ASC 815 require that all cash flows related to a derivative instrument containing an other-than-insignificant financing element at inception be reflected in the borrower's statement of cash flows as cash flows from financing activities.

Refer to our FRD, *Derivatives and hedging*, and section 5.8, *Derivatives and hedging*, of our FRD, *Statement of cash flows*, for additional information.

## Leases

The effects of the current economic environment may impact various aspects of real estate entities' revenue recognition under ASC 842, *Leases*.

### Collectibility

Real estate entities should consider how a deterioration in the creditworthiness of their tenants may change their assessment of collectibility of lease payments. The following table highlights how the collectibility assessment affects lessors' subsequent measurement of lease payments.

Sales-type lease	Direct financing lease	Operating lease
<p>If collectibility is probable at lease commencement, net investment is evaluated for impairment under ASC 310, <i>Receivables</i>, (before the adoption of ASU 2016-13, <i>Measurement of Credit Losses on Financial Instruments</i>) or ASC 326 (after the adoption of ASU 2016-13). Refer to section 2.11.3, <i>Leases</i>, of our FRD, <i>Credit impairment under ASC 326</i>, for additional details.</p> <p>If collectibility is not probable at lease commencement, refer to section 5.2.1.2, <i>Initial recognition and measurement when collectibility is not probable at lease commencement – sales-type leases</i>, of our FRD, <i>Lease accounting – Accounting Standards Codification 842, Leases</i>, for additional details.</p>	<p>Net investment is evaluated for impairment under ASC 310 (before the adoption of ASU 2016-13) or ASC 326 (after the adoption of ASU 2016-13). Refer to section 2.11.3, <i>Leases</i>, of our FRD, <i>Credit impairment under ASC 326</i>, for additional details.</p>	<p>If collectibility is probable, recognize income generally on a straight-line basis.</p> <p>If collectibility is not probable, income recognition is constrained to the lesser of cash collected, or lease income reflected on a straight-line or another systematic basis, plus variable rent when it becomes accruable.</p> <p>If the collectibility of the lease payments subsequently becomes probable, recognize a cumulative catch-up adjustment for any difference between the lease income that would have been recognized if collectibility had always been assessed as probable and the lease income recognized to date.</p> <p>Refer to section 5.4, <i>Operating leases</i>, of our FRD, <i>Lease accounting – Accounting Standards Codification 842, Leases</i>, for additional details.</p>



For a discussion of how collectibility of lease payments from a new tenant affects the classification and initial recognition and measurement of a lease, refer to the table in section 5.1.4, *Collectibility*, of our FRD, [\*Lease accounting – Accounting Standards Codification 842, Leases\*](#).

#### ***Lease modifications for operating leases***

The current environment may prompt negotiations between lessors and lessees to modify lease terms. For example, the rise in hybrid work arrangements could lead lessees to reconsider their office needs, which may result in shorter lease terms, reductions in leased space or rent amounts, or early lease terminations. If a lease continues to exist, a lease modification can result in either a separate contract (accounted for in the same manner as any other new lease) or a change in the accounting for the existing lease (requiring reassessment of lease classification and remeasurement of remaining consideration).

When the parties agree that a lease will be terminated before the expiration of the lease term but the termination will be effective at a future date (i.e., a lessee does not immediately cease using the underlying asset), the change to the lease is generally accounted for as a lease modification that shortens the lease term rather than a lease termination, and income is recognized over the new lease term. This type of modification can occur if a termination is agreed to, but the lessee is given a month to move out, for example.

Refer to our FRD, [\*Lease accounting – Accounting Standards Codification 842, Leases\*](#), for additional information.

#### **Share-based payment awards**

##### ***Award modifications***

Entities may revise their compensation plans to incentivize management if share prices are depressed as a result of current conditions. This may result in an amendment to the terms or conditions of share-based payment awards. If such amendments change an award's fair value, vesting conditions or classification, the entity has to apply modification accounting. When calculating the compensation cost to recognize for a modification, an entity generally has to determine on the date of the modification whether, based on current circumstances, it is probable that the awards would vest under either the original vesting conditions or the new vesting conditions, or both.

Modifying share-based payments can have tax consequences; therefore, entities should consult with their tax advisers before doing so.

##### ***Forfeitures***

Forfeitures generally result from the failure to satisfy service or performance conditions. Entities that estimate forfeitures related to service conditions may need to consider how the economic environment will impact forfeiture activity.

##### ***Measurement of share-based awards***

The deterioration of economic conditions may affect inputs used to determine the fair value of share-based payment awards (e.g., risk-free rate, volatility, current share price). Refer to our FRD, [\*Share-based payment\*](#), for more information.

## Financial statement disclosures

The financial statement disclosures for affected real estate entities and their lenders will vary depending on the magnitude, duration and nature of the effects on their businesses and the availability of information. Entities will need to closely monitor developments and assess the implications for their financial reporting.

### Risks and uncertainties

ASC 275 requires disclosures about certain risks and uncertainties, including qualitative disclosures about risks and uncertainties that in the near term (i.e., within one year from the date of the financial statements) could significantly affect the amounts reported in the financial statements or the functioning of the reporting entity.

Affected entities may be required under ASC 275 to disclose certain significant estimates and concentrations (e.g., concentration of business volume with a particular tenant or type of commercial property or geographic area) that make an entity vulnerable to the risk of a near-term severe impact. These disclosures may be necessary for entities directly or indirectly affected by the current economic environment.

### SEC reporting and disclosures

SEC registrants need to consider a number of SEC reporting and disclosure requirements. Entities should carefully evaluate how economic conditions may affect their business and provide disclosures on the effects in sufficient detail. In its reviews of periodic filings, the SEC staff has been asking about the effects of macroeconomic factors and challenging the sufficiency of disclosures when risk factor disclosures are too general or when the discussion of period-to-period changes does not include the quantitative and qualitative effects of each factor contributing to the change. Entities also need to make sure their disclosure controls and procedures are operating effectively so they can produce the necessary robust disclosures in a timely manner.

### Management's discussion and analysis

Entities are required to disclose any unusual or infrequent events, transactions or significant economic changes that materially affected income from continuing operations (such as lost revenue or costs attributable to the current economic environment) in MD&A. They are also required to disclose known trends or uncertainties that have had, or are reasonably expected to have, a material effect on their revenue or income from continuing operations, liquidity or capital resources.<sup>6</sup> Known trends or uncertainties may include higher interest rates or lower occupancy rates that could negatively affect income from operations, for example.

Entities may also need to consider the effects on their capital resources and liquidity, including situations in which the sources and uses of cash could be materially affected and potentially lead to uncertainty about an entity's ability to continue to meet covenants of credit agreements. An entity that is having liquidity issues should evaluate the adequacy of its disclosures related to potential capital needs and alternative sources of capital to fund those needs. If a material liquidity deficiency has been identified, disclosures may need to include the course of action the entity has taken or proposed taking to remedy the deficiency.

Entities should carefully evaluate how economic conditions may affect their business and provide disclosures on the effects in sufficient detail.

It may also be appropriate for entities to include disclosures related to any heightened uncertainty or changes in key assumptions underlying critical accounting estimates. We believe registrants should continually reassess which estimates they identify as critical accounting estimates, given the significant level of judgment involved. That is, registrants need to consider the impact of any changes in the level of judgment and estimation uncertainty and the materiality of the estimate's reasonably likely impact on the financial statements.

Refer to our SEC Reporting Update, [\*Highlights of trends in 2023 SEC staff comment letters\*](#), for more information.

### **Risk factor disclosures**

Registrants should consider whether their discussion of material risk factors in annual reports on Form 10-K reflects the direct and indirect effects of the current lending environment, higher interest rates and other macroeconomic factors. In addition, registrants are also required to disclose in each quarterly report on Form 10-Q any material new risks or changes in risk factors. Risk factors may need to be added or updated as appropriate in each subsequent quarterly report if they are still applicable.

### **Form 8-K**

SEC registrants should have robust disclosure controls and procedures in place so they can timely disclose material information related to macroeconomic events and identify any triggering events that may warrant the filing of a Form 8-K. For example, an entity will need to consider whether the effects of macroeconomic factors, such as reductions in market prices of commercial real estate or declining occupancy rates for certain commercial property, trigger a material impairment charge, which generally would be required to be reported within four business days under Item 2.06 of Form 8-K. Disclosure in Form 8-K is not required if the conclusion is made in connection with the preparation, review or audit of financial statements required to be included in a timely filing and such disclosure is included in the timely filed report.

### **Other disclosure considerations**

SEC registrants may need to consider adjusting disclosures in other areas of their annual reports and registration statements to reflect the direct and indirect effects of the current lending environment, rising interest rates and other macroeconomic factors, including the description of their business, properties and human capital resources under Items 101 and 102 of Regulation S-K.

### **Internal control over financial reporting**

Real estate entities and their lenders should consider the effects of recent developments in the industry and the lending environment to determine whether changes in internal controls are needed to respond to any heightened risks (e.g., impairment risk may be more prevalent if holding periods are impacted due to refinancing risk). An entity may need to identify new controls or modify existing controls, depending on the facts and circumstances.

Entities also should consider whether any changes they make to their internal control over financial reporting are material and, therefore, are required to be disclosed.

### **How we see it**

Given today's higher interest rates, tighter lending standards and the decline in occupancy rates for certain commercial real estate properties, real estate entities and their lenders need to continuously evaluate the impact on their business and financial reporting and provide disclosures on material impacts.

## Endnotes

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- <sup>1</sup> Neil Callanan, "A \$1.5 Trillion Wall of Debt Is Looming for US Commercial Properties" – Bloomberg News, 8 April 2023.
- <sup>2</sup> "The July 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices" – Board of Governors of the Federal Reserve System, 31 July 2023.
- <sup>3</sup> "Property Prices Continue to Decline" – Green Street, 7 September 2023.
- <sup>4</sup> 11 June 2018 Credit Losses TRG Meeting; [see meeting minutes](#).
- <sup>5</sup> The fair value of a foreclosed property, less costs to sell, becomes the cost basis of the property if it is received to satisfy a loan receivable and meets the held-for-sale classification criteria in ASC 360-10 at the time of foreclosure. For more information, refer to section 4.2.8 of our FRD, [Impairment or disposal of long-lived assets](#).
- <sup>6</sup> Item 303 of Regulation S-K.

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## Appendix A

This appendix provides links to FRDs referenced throughout this Technical Line and other relevant publications. See below for the breakout by section.

### Asset impairments

- ▶ Financial reporting developments, [\*Impairment or disposal of long-lived assets\*](#)
- ▶ Financial reporting developments, [\*Equity method investments and joint ventures\*](#)
- ▶ Financial reporting developments, [\*Credit impairment under ASC 326\*](#)

### Sales and transfers of real estate assets

- ▶ Financial reporting developments, [\*Gains and losses from the derecognition of nonfinancial assets \(ASC 610-20\)\*](#)

### Debt modifications and debt covenant violations

- ▶ Financial reporting developments, [\*Issuer's accounting for debt and equity financings \(before the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity\)\*](#)
- ▶ Financial reporting developments, [\*Issuer's accounting for debt and equity financings \(after the adoption of ASU 2020-06, Accounting for Convertible Instruments and Contracts in an Entity's Own Equity\)\*](#)

### Derivatives and hedge accounting

- ▶ Financial reporting developments, [\*Derivatives and hedging\*](#)
- ▶ Financial reporting developments, [\*Statement of cash flows\*](#)

### Leases

- ▶ Financial reporting developments, [\*Lease accounting – Accounting Standards Codification 842, Leases\*](#)
- ▶ Financial reporting developments, [\*Credit impairment under ASC 326\*](#)

### Share-based payment awards

- ▶ Financial reporting developments, [\*Share-based payment\*](#)

### SEC reporting and disclosures

- ▶ SEC Reporting Update, [\*Highlights of trends in 2023 SEC staff comment letters\*](#)