Statement of

Kevin Stoklosa

Assistant Technical Director

Financial Accounting Standards Board

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"Commercial Real Estate:  A Chicago Perspective on Current

Market Challenges and Possible Responses"

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Good afternoon. Mr. Chairman and members of the Subcommittee, my name is Kevin Stoklosa, Assistant Director of Technical Activities at the Financial Accounting Standards Board ("FASB"). Thank you for inviting me to participate in today's important hearing. I have brief prepared remarks and would respectfully request that the full text of my testimony be entered into the public record.

Since 1973, the FASB has established standards of financial accounting and reporting for nongovernmental entities, including both businesses (public and private) and not-for-profit organizations. Those standards are recognized as authoritative Generally Accepted Accounting Principles (GAAP). GAAP is essential to the efficient functioning of the U.S. economy because investors, creditors, donors, and other users of financial reports rely heavily on credible, transparent, comparable, and unbiased financial information to make resource allocation decisions.

Because the actions of the FASB affect so many organizations, the FASB carefully considers the views of all interested parties, including users, auditors, regulators, and preparers of financial information in its decision-making process. Although the FASB and regulators have different objectives, because of their keen interest in GAAP financial statements as a starting point in their assessment of the safety and soundness of an entity's financial position, the FASB members and staff regularly meet with regulators to obtain their input and better our understanding of their views.

The Subcommittee is examining the causes of the turmoil in the commercial real estate (CRE) market, and the state of the market. I would like to focus my remarks on the FASB's accounting guidance that most significantly affects these companies.

From the perspective of entities that develop, purchase, or own commercial real estate, the accounting guidance requires those entities to measure the investment at historical cost. Under this accounting model entities are required to capitalize certain costs incurred in the development or acquisition of commercial properties. GAAP provides prescriptive guidance on what costs should be capitalized and when capitalization of those costs should cease to continue. Testing properties for impairment during both the construction stage and once the property is available for occupancy is also required.

As a result of input from both preparers and users of financial statements, the FASB has recently added a project to its agenda to reconsider whether entities should be permitted (or required) to measure investment properties at fair value, instead of historical cost. International accounting standards currently permit investment properties to be measured at fair value.

From the perspective of entities that finance commercial real estate, the accounting guidance is based on whether the creditor holds the loans or whether the creditor transfers or securitizes the loans. Last year, the FASB issued Statements 166 and 167 which were needed improvements to the accounting and reporting for transfers of financial assets, including securitizations, and other involvements with special purpose entities.  This guidance, which still allows for entities to obtain sale accounting (and thus gain on sales) should result in more assets involved in such transactions staying on the books of the sponsoring financial institutions, by significantly reducing the ability to get off-balance sheet treatment for securitizations and similar arrangements where significant risk is retained by the entity.  Although this guidance will better reflect financial institutions exposure to risks, it may affect their ability to comply with the regulatory capital requirements and therefore affect the liquidity available to the CRE industry.

Mr. Chairman that concludes my prepared remarks.  I would like to thank you and the Subcommittee for the opportunity to testify this afternoon.  I would be happy to answer any questions.