NAREIT Financial Standards Update

National Association of Real Estate Investment Trusts®
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Consensus Reached on Global Real Estate Financial Statement Model

Global Coalition Discusses Industry Reporting Model with FASB/IASB Staff

The FASB/IASB has on its agenda the *Financial Statement Presentation* project (the Project). The goal of the Project is to develop form and content of the basic financial statements in order to enhance their usefulness to users. A fundamental premise of the Project is that the financial statements should present information in a way that reflects how management views the operating results and financial condition of their company. The Project provides a unique opportunity for the real estate industry to create model financial statements that reflect how the industry's managements and financial statement users evaluate the operating performance, financial strength and investment quality of companies that own and operate investment property.

During 2005, NAREIT developed a set of model real estate industry financial statements. In 2006, NAREIT reached out to form a coalition of real estate organizations from around the world in an effort to develop a global real estate industry model. In September 2007, members of the Real Estate Equity Securitization Alliance (REESA) approved a global model (with the exception of ARES, which continues to study the matter). Members of REESA include:

Association for Real Estate Securitization (Japan), ARES
Asian Public Real Estate Association, APREA
British Property Federation, BPF
European Public Real Estate Association, EPRA
National Association of Real Estate Investment Trusts, NAREIT
Property Council of Australia, PCA
Real Property Association of Canada, REALpac

The approved model assumes that investment property is reported at fair value and includes operating metrics similar to Net Operating Income and Funds From Operations. On Oct. 23, 2007, the financial statement model was presented to the FASB and IASB staff by NAREIT staff and other members of the global coalition.

This meeting was very successful. The Boards' staff asked thoughtful questions regarding the model and clarified guidance that had been recently issued in connection with the Project, including the application of the cohesiveness principal. The staff also provided their

Highlights

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preliminary views regarding the model and an understanding of how certain tentative conclusions reached by the Boards with respect to the Project relate to the model. The coalition is considering whether or not the model should be modified based on this discussion with FASB/IASB staff. The model will be used as a basis for further discussion with the FASB and IASB and for responding to proposed standards that will be issued by the Boards. A "preliminary views document" on the Project is expected to be issued in the first half of 2008.

NAREIT Discusses Model with Association for Real Estate Securitization (ARES)

Steve Wechsler, George Yungmann and Teresa Neto, coalition representative from REALpac, met with ARES staff and membership in Tokyo on Dec. 4 to present the global real estate industry financial statement model. ARES members were particularly interested in the model's format and in the relationship between the model and the broader efforts to globally harmonize accounting standards.

Further Information and Background

Further information and background with respect to this important long-term FASB/IASB project is available by clicking HERE.

NAREIT Helps FASB in Its Examination of Fair Value Reporting for Investment Property

In the context of its Fair Value Option project, the FASB has provided under the Phase I standard, FAS 159 *Fair Value Option for Financial Assets and Financial Liabilities*, the option to report financial assets and financial liabilities, including certain equity method investments in unconsolidated affiliates, at fair value.

In Phase II of the project, the FASB is examining whether to provide an option to report investment property at fair value. In examining this question, the Board will consider the standards set forth in International Accounting Standard No. 40 *Investment Properties* (IAS 40), which requires that the fair value of investment property be reported either in the balance sheet or in notes to the financial statements.

NAREIT is helping the FASB in its examination of reporting investment property. Recently, FASB staff asked if NAREIT could assist them in understanding the implementation of IAS 40. Staff also inquired as to whether modifications to IAS 40 would provide more effective financial reporting. In December, NAREIT arranged conference calls with the FASB staff and individuals from Europe, the U.K. and the U.S. who have experience in implementing IAS 40. Participants included financial statement preparers, valuation consultants and auditors. These calls were very useful to FASB staff, as well as to NAREIT staff toward understanding the application of IAS 40.

On Jan. 25, 2008 NAREIT representatives will meet with the FASB to discuss its views with respect to reporting investment property at fair value, including certain modifications to IAS 40 that NAREIT believes would enhance the usefulness of fair value reporting by NAREIT member companies. At this meeting, NAREIT will also share its views with respect to certain FASB/IASB thinking regarding possible new lease accounting standards.

The FASB expects to issue an exposure draft in connection with this project in the second quarter of 2008. Click HERE to access further information regarding the FASB's Fair Value Option, Phase II project.

NAREIT Succeeds in Buy-Sell Debate

On Nov. 29, 2007, the FASB's Emerging Issues Task Force (EITF) concluded that the impact of buy-sell clauses on accounting for real estate sales to joint ventures should be consistent with NAREIT's position and current industry practice. The question addressed by EITF Issue No. 07-6, *Accounting for the Sale of Real Estate When the Agreement Includes a Buy-Sell Clause* is whether the inclusion of a buy-sell clause in a joint venture agreement should, by itself, preclude an investor from recognizing a partial sale and profit on contributions of property to the joint venture.

The EITF Issue No. 07-6 that was exposed for comment indicated that a buy-sell clause, by itself, should not preclude sale and profit recognition and provided a number of factors that should be considered in evaluating whether a joint venture investor that contributes property to a venture has significant continuing involvement in the property to an extent that sale and profit recognition should be precluded. NAREIT urged the EITF to eliminate these specific factors from any final guidance, and the EITF agreed with this position. The Board approved the issuance of EITF Issue No. 07-6 at its December 12, 2007 meeting.

The latest EITF information regarding Issue No. 07-6 is available HERE. NAREIT's letters to the EITF are available HERE.

FASB Proposed Guidance on Accounting for Certain Convertible Debt Delayed Until 2009

In response to comment letters submitted by NAREIT, NAREIT members and others, the FASB has postponed the issuance of FASB Staff Position (FSP) APB 14-a, which addresses accounting for convertible debt that may be settled either wholly or partially in cash. The delay effectively results in at least a one-year delay in the effective date of any new guidance.

NAREIT and a number of NAREIT member companies submitted comment letters on the exposure draft, generally objecting to the issuance of the proposed guidance. NAREIT's Oct. 15, 2007 letter, available by clicking HERE, argued that:

- The proposed accounting would not faithfully represent the economic cost of this capital;

- The retroactive application of the proposed guidance would be inappropriate since companies have been following effective U.S. GAAP; and,

- Any modification to the accounting for these debt instruments should be developed in the context of the FASB/IASB joint liabilities and equity project.

If the Board's preliminary decisions reflected in the exposure draft would have been adopted, companies would have been required to account for debt and equity components of these instruments separately. This change in accounting could have negatively affected Net Income and Funds From Operations (FFO), perhaps materially, on a retroactive basis. We have been advised that NAREIT member companies have issued at least $20 billion of this type of debt.

SEC Considering Further Delay for Small Company Section 404 Compliance

On Dec. 12, 2007, Securities and Exchange Commission (SEC) Chairman Christopher Cox announced his intention to propose a further delay in requiring companies with public float of less than $75 million to include an auditor's attestation report on internal controls in their annual reports. For calendar-year companies, this requirement would not be effective until annual reports for 2009 are filed with the SEC in early 2010. A final decision regarding the delay will be made in early 2008.

Chairman Cox also announced that the Commission's Office of Economic Analysis is planning to complete a study of the costs and benefits of complying with Section 404 by the end of June 2008.

SEC Issues Concept Release Regarding the Possibility of U.S Issuers Utilizing IFRS Instead of U.S. GAAP

On Aug. 7, 2007, the SEC published Concept Release 33-8831 *Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards* (Release). The Release solicited information regarding the possibility of allowing U.S. issuers to report under International Financial Reporting Standards (IFRS) instead of U.S GAAP. The SEC has already received overwhelmingly favorable feedback with respect to this issue in initial communications with analysts, public accounting firms and companies, although many of these commentators supported U.S. issuers adopting IFRS only if, after a transitional period, such adoption was mandatory. The SEC issued the Release to gather information from a wider audience to ensure this monumental change would in fact positively impact U.S. markets.

In a question format, the Release inquired about myriad issues including whether a consistent application of IFRS is attainable versus the feared "multiplicity of standards under the same name." NAREIT did not issue a comment letter on the Release due to the wide range of differing member opinions on this matter.

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AICPA Proposed Guidance on the Scope for Applying the AICPA Investment Company Audit and Accounting Could Impact Certain REITs and Affiliates

On June 11, 2007, the AICPA issued SOP 07-1 *Clarification of the Scope of the Audit and Accounting Guide "Investment Companies" and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (SOP). The SOP provides criteria for determining whether an entity must apply the special accounting included in the Guide. The special accounting includes the requirement to report investment property at fair value.

The Guide defines an investment company as an entity "whose business purpose and activity are investing in multiple substantive investments for current income, capital appreciation, or both, with investment plans that include exit strategies." The entity's assets, liabilities and activities are limited to investment purposes. The SOP explicitly states that "involvement in the day-to-day management of investees, their affiliates or other investment assets by the entity or its affiliates provides evidence that the entity is investing for strategic operating purposes" and, therefore, the entity would generally not be considered an investment company.

NAREIT believes that REITs and real estate operating companies that manage their investment properties would not be considered investment companies but that others may fall within the scope of the SOP. This may be the case when an affiliate, *e.g.,* a joint venture or an investment fund, meets the criteria defining an investment company, or in the case of a non-traded REIT that promises its shareholders a liquidity event at a date certain. Further, NAREIT believes that the special accounting would not generally be included in the consolidated financial statements of the REIT even when an affiliate prepares reports based on the SOP. A brief summary of the SOP is available by clicking HERE.

On Oct. 16, 2007, NAREIT submitted a letter to the FASB requesting that the effective date (January 1, 2008 for calendar year companies) be deferred to allow companies to better understand the SOP and its applicability to real estate companies. The National Council of Real Estate Investment Fiduciaries (NCREIF) also petitioned the FASB to defer the effective date of the SOP. At its meeting on Oct. 1, 2007, the FASB unanimously approved the indefinite deferral of the SOP's effective date.

We suggest that you discuss any questions concerning the SOP or its potential application to your company or its affiliates with your accounting firm.

FASB Announces Periodic Webcasts on Accounting Issues

On Dec. 13, 2007, the FASB announced that it would launch a series of Webcasts starting Jan. 8, 2008 to focus on topics important to its constituents. In the January Webcast titled *Towards a Global Reporting System: Where We Are and Where We Are Going*, a panel will discuss the implications of moving the U.S. toward adoption of IFRS. The discussion will be moderated by Wall Street Journal reporter David Reilly. Topics to be discussed will include:

- Steps necessary to ensure a successful transition to IFRS;
- How this transition will provide better information to investors; and
- Progress made by FASB and IASB to create a common set of high quality global accounting standards.

Further information regarding the Webcast, including registration, is available by clicking HERE.

2008 Law & Accounting Conference

The 2008 NAREIT Law and Accounting Conference will be held at the Fairmont Scottsdale Princess Hotel in Scottsdale, Arizona on March 19 through 21. Information regarding the agenda and registration will be distributed in January and will be available on NAREIT's web site.

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