April 2004

NAREIT Financial Standards Update

NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

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FASB

Unanimously votes not to clear AcSEC's Proposed PP&E (Cost Capitalization) SOP

On April 14, 2004, the Financial Accounting Standards Board (FASB or Board) unanimously voted not to "clear" the cost capitalization proposal submitted to it by AICPA's Accounting Standards Executive Committee. As you know, NAREIT has strongly opposed this proposal, expressing its views through a series of written submissions as well as attendance at meetings (including an educational session with the members of FASB last November).

As part of the clearance discussions, the Board noted concerns expressed by the real estate community as well as others. Based on comments made by Bob Herz, FASB Chairman, and other Board members, this development is likely to mean that any future action in this area will only take place as part of a wider FASB project connected to the convergence of U.S. GAAP with international accounting standards dealing with property, plant and equipment; depreciation; and fair value reporting for investment property. Click HERE to read the FASB meeting minutes.

Issues Exposure Draft on Share-Based Payment

On March 31, 2004, the FASB released for public comment an exposure draft (ED) entitled *Share-*

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Based Payment, an amendment of FASB Statements No. 123 and 95. This ED proposes that the cost of all forms of equity-based compensation (EBC) granted to employees, excluding employee stock ownership plans, be recognized in a company's income statement. The award's cost would be measured at its fair value. While the FASB would not require the use of a particular valuation model, it prefers the binomial approach to valuing EBC at its fair value. The FASB believes that the proposed guidance will make EBC more transparent to investors.

If issued as a final standard, the ED will replace the guidance in FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. The provisions of the ED generally converge with the guidance of the International Accounting Standards Board (IASB) in International Financial Reporting Standard No. 2, *Share-Based Payment*.

Comments on the ED are due June 30, 2004. Click HERE to access the ED. Please contact Gaurav Agarwal, 202-739-9442 or gagarwal@nareit.com, if you feel that this ED may have a significant impact on your financial reporting and if you would like to participate in developing a NAREIT comment letter.

SEC

Amends Form 8-K Disclosure Requirements and Filing Deadlines; Adopts NAREIT's Suggestion Not To Require Disclosure of Non-binding Agreements

On March 11, 2003, the Securities and Exchange Commission (SEC) voted to adopt amendments to Form 8-K, the Exchange Act form used by public companies to disclose important corporate events on a current basis. The amendments will add ten disclosure items to Form 8-K, including transferring two items to the current report from the periodic reports. The amendments will also provide investors with timelier disclosure by replacing the current five business and 15 calendar day Form 8-K deadlines with a new four-business day deadline. However, in response to strong opposition by NAREIT and our members, the Commission eliminated the proposed requirement that companies disclose their entry into non-binding agreements. In addition to written comments regarding this issue, NAREIT staff and member representatives met with SEC staff to share the industry's basis for opposing the proposed requirement.

The amendments are responsive to the current disclosure goals of Section 409 of the Sarbanes-Oxley Act by requiring public companies to disclose, on a "rapid and current basis," material information regarding changes in a company's financial condition or operations which the Commission, by rule, determines to be necessary or useful for the protection of investors and in the public interest.

The eight new disclosure items include:
- entry into a material non-ordinary course agreement;
- termination of a material non-ordinary course agreement;
- creation of a material direct financial obligation or a material obligation under an off-balance sheet arrangement;
- triggering events that accelerate or increase a material direct financial obligation or a material obligation under an off-balance sheet arrangement;
- material costs associated with exit or disposal activities;
- material impairments;

- notice of delisting or failure to satisfy a continued listing rule or standard; transfer of listing; and
- non-reliance on previously issued financial statements or a related audit report or completed interim review (restatements).

The two disclosure items transferred, in part, from the periodic reports are unregistered sales of equity securities and material modifications to rights of security holders.

Expanded disclosure items include departure of directors or principal officers, election of directors, or appointment of principal officers and amendments to Articles of Incorporation or Bylaws and change in fiscal year.

The amendments will create a limited safe harbor under Exchange Act Section 10(b) and Rule 10b-5 for failure to file timely seven of the new items on Form 8-K. The safe harbor will not apply to, or impact, any other duty to disclose a company may have and extends only until the due date of the company's periodic report for the relevant period.

Compliance with these amendments will be required for filings made on or after August 23, 2004. Click HERE to access the final rule.

IASB

Agrees with NAREIT Regarding the Definition of Discontinued Operations

In the January 2004 Financial Standards Update, NAREIT had reported that in October 2003 the International Accounting Standards Board (IASB) had issued an exposure draft, *Disposal of Non-current Assets and Presentation of Discontinued Operations* as it considered FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (SFAS 144) to further the convergence of accounting standards around the world. On March 31, 2004, the IASB issued its final International Financial Reporting Standard #5, *Non-Current Assets Held for Sale and Discontinued Operations (IFRS 5)*. In the final rule, the IASB chose not to accept the narrow definition regarding the size of the unit that could be classified as discontinued in accordance with SFAS 144 which requires that virtually all property sales be reported as discontinued operations. The IASB agreed with the comments expressed by NAREIT in its comment letter dated October 20, 2003. Click HERE to access NAREIT's comment letter.

In its comment letter NAREIT supported the Board's efforts to converge accounting standards around the world. However, in response to Question 8, Classification as a discontinued operation, we indicated that it is not appropriate for comparative financial statements to be restated every time a company disposes a property. We reiterated that treating all dispositions as discontinued operations and, therefore, constantly restating previously reported operating results, causes a great deal of confusion to financial statement users. Our comment letter suggested that the rules of classification as a discontinued operation should only apply to significant components of an entity's business and not to individual sales of long-term assets. IFRS 5 states that a discontinued operation should be a major line of business or geographical area of operations. The IASB intends to work with the FASB to arrive at a converged definition of a discontinued operation in the near future. Click HERE to access the news release regarding IFRS 5 on the IASB website.

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PCAOB

Approves Standard For Audits Of Internal Control Pursuant To Section 404 Of The Sarbanes-Oxley Act Of 2002

On March 9, 2004, the Public Company Accounting Oversight Board (PCAOB) approved an auditing standard for audits of internal control over financial reporting and proposed amendments to the Board's existing interim auditing standards to conform them to the new standard. The Auditing Standard No. 2, "*An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*," addresses both the work that is required to audit internal controls over financial reporting and the relationship of that audit to the audit of the financial statements.

Section 404(a) of the Sarbanes-Oxley Act of 2002, and the Securities and Exchange Commission's (SEC) related implementing rules, requires the management of a public company to assess the effectiveness of the company's internal control over financial reporting. Section 404(b) of the Act, as well as Section 103, directed the PCAOB to establish professional standards governing the independent auditor's attestation, and reporting, on management's assessment of the effectiveness of internal control.

Despite controversy, the PCAOB did not scrap a requirement that auditors judge the effectiveness of audit committee members who have the power to hire and fire them.

Whenever auditors find issues with audit committees, the final rule requires they report them to the full board. The final Standard acknowledges that "the company's board of directors is responsible for evaluating the performance and effectiveness of the audit committee; this standard does not suggest that the auditor is responsible for performing a separate and distinct evaluation of the audit committee." Virtually all NAREIT member companies must begin to comply with Section 404 rules and related standards in their 2004 annual reports.

The Standard will not be final until approved by the SEC. The SEC has issued the Standard as a proposed SEC rule and has asked for comments on the proposal by the end of April. Click HERE to access the proposed rule. If you would like to participate in considering NAREIT's comments on this proposal, please contact Gaurav Agarwal, 202-739-9442 or gagarwal@nareit.com, or Robert Cohen, 202-739-9415 or rcohen@nareit.com.

NAREIT

Comments on FASB's Exposure Draft on Exchanges of Productive Assets

In the January 2004 Financial Standards Update, NAREIT reported that FASB had issued an exposure draft (ED) titled *Exchanges of Productive Assets-an amendment of APB Opinion No. 29*. This proposed ED would eliminate paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, which establishes an exception to the general principle that exchanges of nonmonetary assets should be recorded at the fair value of the assets exchanged. Paragraph 21(b) concludes that non-monetary exchanges of "similar productive assets" should not result in gain recognition because the earnings process has not been culminated. This proposed ED would eliminate the concept of "similar productive assets" and require that non-monetary exchanges of productive assets be accounted for based on the fair values of the assets involved, unless the exchange transaction does not have commercial substance. An exchange would be deemed to have commercial substance if a) the configuration (risk, timing or amount) of the expected future cash flows of the asset(s) received differs from the configuration of the expected future cash flows of the asset(s) transferred, or b) the entity-specific value of the portion of the reporting entity's operations affected by the transaction changes as a result of the exchange, and either of these changes are significant.

NAREIT's comment letter dated April 13, 2004 supported the requirements in the ED. Our comment letter indicated that the application of the notion of commercial substance would result in financial reporting that is more representationally faithful and better portrays the economics of the transaction. In addition, we agreed that nonmonetary exchanges of real estate should continue to be accounted for under APB Opinion No. 29, as amended by this proposed statement. Click HERE to read NAREIT's comment letter.

2004 Law & Accounting Conference

NAREIT's Law & Accounting Conference was held from March 31 through April 2, 2004 in Hollywood, Florida at the Westin Diplomat Resort & Spa. The Conference was very successful and was attended by 900 financial, legal and other professionals who are either employed by our corporate members or serve them as outside experts. The program provided a broad range of learning experiences. Sessions covered recently issued and proposed accounting standards, the new corporate governance and financial reporting environment, the current capital markets and best practices with respect to financial reporting. Of special interest to the accountants and lawyers in the audience were the SEC Hot Topics and the Cost Capitalization sessions.

At the Accounting Committee Meeting, John Lindell and Ray Milnes of KPMG, presented their firms' views on the accounting for an acquisition

Navigating the Currents: Sarbanes-Oxley Implementation panelists: Clay Chilton, ProLogis; Bill Tomazin, KPMG; Esther Blum, Taubman Centers, Inc.; and Mark Schonberger, Paul Hastings Janofsky & Walker; (not pictured: Richard Burton, Host Marriott)

pursuant to FASB Statement No. 141, *Business Combinations*. Chris McGee of Ernst & Young reviewed the FASB's exposure draft titled *Share-Based Payment, an amendment of FASB Statements No. 123 and 95*. NAREIT Vice President, Financial Standards, George Yungmann, discussed issues related to investment property depreciation, while NAREIT's Director, Financial Standards, Gaurav Agarwal, presented the results of the 2003 year end FFO reporting review.

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