NAREIT Financial Standards Update

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Financial Standards Update

NAREIT Meets with the SEC

On July 2, 2008, NAREIT representatives met with the Securities Exchange Commission (SEC) staff from the Office of the Chief Accountant and the Division of Corporate Finance. The purpose of the meeting was to discuss the industry generally, including the economic characteristics of the investment property business, and to share NAREIT's views on a number of FASB and IASB financial standards projects. The projects discussed included:

- FASB's *Fair Value Option – Phase 2, Investment Property*
- FASB/IASB *Financial Statement Presentation*
- FASB/IASB *Lease Accounting*

SEC staff participating in the discussion included:

- Conrad Hewitt, Chief Accountant of the SEC
- Jim Kroeker, Deputy Chief Accountant – liaison with FASB, IASB, EITF and IFRIC
- Associate Chief Accountants responsible for liaison on the FASB Fair Value Option project, the FASB/IASB Financial Statement Presentation project and the joint Lease Accounting project
- Also present were Linda van Doorn, Louise Dorsey and Karen Garnett from the Division of Corporate Finance

Highlights

Representatives from NAREIT included:

- Martin Cohen, Co-Chairman and Co-CEO of Cohen & Steers
- Jim Fleming, EVP and CFO of Cousins Properties
- Steve Wechsler, Tony Edwards, George Yungmann and Sally Glenn from NAREIT

In providing the introduction and overview of the meeting, Steve Wechsler expressed NAREIT's gratitude for the opportunity to present its views to the SEC and focused the meeting on NAREIT's commitment to supporting the development of relevant and high quality financial reporting. He said that NAREIT had become increasingly active and engaged in recent years with respect to a host of Generally Accepted Accounting Principles (GAAP) and International Accounting Standards (IAS) issues; and that NAREIT views the specific projects at hand, as well as the general FASB/IASB "convergence" process underway, as a meaningful opportunity to improve accounting for the investment property business in a manner equally beneficial to users, investors and managers. He noted that the specific projects under discussion had the potential to provide users of the industry's financial statements with information that would be more relevant to the investment property business and to better reflect the operating performance and financial position as viewed by a company's management. NAREIT's other representatives then discussed the industry's business and economic characteristics and provided NAREIT's specific views on each of the three projects.

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The SEC staff asked several questions about NAREIT's presentation, especially with regards to reporting investment property at fair value since the SEC was scheduled to hold a roundtable on fair value accounting standards a week later, on July 9, 2008.

In addition, Conrad Hewitt inquired about how the global real estate financial statement model, which was developed in connection with the FASB/IASB *Financial Statement Presentation* Project, would translate into Extensible Business Reporting Language (XBRL). NAREIT staff described its recent involvement in the comment process of the U.S. GAAP real estate taxonomy and the International Financial Reporting Standards (IFRS) taxonomy, as well as facilitating XBRL information sessions. NAREIT further explained that it would be ideal for the global real estate financial statement model to be programmed as the XBRL real estate taxonomy in the future.

Finally, NAREIT representatives provided the SEC with the views of NAREIT and its partner organizations around the world on lease accounting issues under review by the FASB and IASB. The FASB/IASB preliminary thinking would require leases associated with lessors of investment property to be reported on balance sheets in two parts – the "fair value of lease receivables" and the "fair value of interests in property residual value." No real estate asset would be reported on the balance sheet. Such thinking also recommended that the lessor's rental revenue should be split into two elements – "interest income" and "principal" payments on the lease receivables. NAREIT representatives indicated to the SEC that NAREIT and its partners around the world would oppose any changes to lease accounting that would re-characterize, in financial statements, a $1 trillion + operating real estate business to a financing business.

We believe this meeting was successful in terms of enhancing NAREIT's relationship with the SEC staff and in terms of the SEC staff gaining an understanding of NAREIT's views on financial standards projects that could have a significant impact on the industry's financial statements.

FASB Drops Accounting for Maintenance Recovery Revenue from its Agenda

At its June 12, 2008 meeting, the FASB's Emerging Issues Task Force (EITF) agreed with NAREIT's position by voting to drop Issue No. 08-2, *Lessor Revenue Recognition for Maintenance Services*, from its agenda. EITF 08-2 raised the issue of how lessors should properly account for reimbursements received from lessees for services performed under a lease contract to maintain the leased asset. NAREIT supported the EITF's examination of current accounting practices for recognizing revenues that reimburse a lessor for maintenance or capital costs by providing information regarding the industry's current accounting practices for common area maintenance and other reimbursable costs. NAREIT also provided information to the EITF as to the impact of proposed changes in accounting for these costs on real estate company financial statements.

In a May 5, 2008 comment letter, NAREIT had recommended that the EITF consider either eliminating this project from its agenda or narrowing its scope to the triggering issue raised with respect to maintenance cost reimbursement arrangements in the airline industry. Click here to access NAREIT's comment letter.

FASB Moves Toward Additional Loss Contingency Disclosures

The FASB released an Exposure Draft, *Disclosure of Certain Loss Contingencies – an Amendment of FASB Statements No. 5 and 141R* ("the ED") that would significantly increase the disclosure requirements for loss contingencies that are within the scope of FASB Statement 5 or are recognized in accordance with Statement 141R at the acquisition date in a business combination (with certain scope exceptions stated in the ED). The purpose of the proposed statement is to improve the quality of financial reporting by expanding disclosures required for most significant loss contingencies. This action is in response to concerns expressed by investors and other financial statement users that current disclosures are not relevant because they do not provide adequate information in a timely manner to assess the likelihood, timing and amount of future cash flows associated with loss contingencies.

The proposed disclosures would not be required if the likelihood of a loss is remote. Contingencies involving unasserted claims or assessments would also be exempt from disclosure under certain criteria specified in the ED.

Additional disclosures required under the ED for each loss contingency or group of similar loss contingencies include:

• The amount of the claim or an estimate of the maximum exposure to loss, if there is no claim or assessment amount. A best estimate of the possible loss or range of loss also could be disclosed if the amount of the claim or assessment or the maximum exposure to loss is not representative of the entity's actual exposure.

• Qualitative information about the contingency, such as a description of the contingency, its current status, the anticipated timing of its resolution, factors that are likely to affect the outcome of the contingency, the entity's qualitative assessment of the most likely outcome of the contingency and significant assumptions made by the entity in estimating the disclosed amounts and in assessing the most likely outcome.

• A qualitative and quantitative description of the terms of relevant insurance or indemnification arrangements that could lead to a recovery of some or all of the possible loss, including any caps, limitations or deductibles that could affect the amount of recovery.

Furthermore, for each period for which a statement of income is presented, an entity would be required to provide a reconciliation in tabular format of the total amount recognized in the aggregate for loss contingencies in its statement of financial position at the beginning and end of the period.

The proposed statement would be effective for annual financial statements issued for fiscal years ending after Dec. 15, 2008, and interim and annual periods in subsequent fiscal years. The FASB is accepting comments on the ED by Aug. 8, 2008. To access the ED, click here.

If you are interested in participating in a task force to evaluate this proposal and assist NAREIT in developing a comment letter to the FASB, please

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contact George Yungmann at gyungmann@nareit.com.

FASB Proposes Guidance on Accounting for Hedging Activities

Last month, the FASB issued an Exposure Draft, *Accounting for Hedging Activities – an Amendment of FASB Statement No. 133* ("the FAS 133 ED"). The primary objectives of the FAS 133 ED are to simplify and improve the accounting and financial reporting for hedging activities, resolve major practice issues that have arisen under FAS 133 and address differences in recognition and measurement between the accounting for derivative instruments and the accounting for hedged items.

One major proposed change from current practice would be the elimination (with two exceptions) of the bifurcation-by-risk model. That is, the FAS 133 ED would require an entity to designate the risk of overall changes in the entire hedged item, which would drastically reduce the ability to hedge individual risks, such as interest rate risk after inception of the debt.

This change would impact common REIT hedging strategies, such as those strategies involving forecasted debt issuances, lines of credit and short-term rollovers, and may affect earnings due to ineffectiveness that may result from designating the overall risk of the hedged item, including any ineffectiveness from credit risk. Furthermore, depending on expected changes due to credit quality, companies may not be able to qualify for hedge accounting with traditional interest-rate-based derivatives.

Other important proposed changes in the FAS 133 ED are the elimination of the shortcut and "critical terms match" methods of measuring ineffectiveness, the removal of the ability to dedesignate a derivative, the limitation of hedging interest rate risk to debt that is designated at the inception of the debt and the requirement of measuring and recording ineffectiveness from underhedges in the income statement for cash flow hedges.

Comments on the FAS 133 ED are due by Aug. 15, 2008. The proposed statement would be effective for fiscal years beginning after June 15, 2009 and interim periods within those fiscal years. To learn more about the issues available for comment and to access the FAS 133 ED, click here.

NAREIT has formed a task force and invites you to participate. Understanding your views on the proposed accounting would assist NAREIT in developing an effective comment letter. Additionally, we recommend that NAREIT members submit individual comment letters to the FASB. If you are interested in joining the task force, please contact Sally Glenn at sglenn@nareit.com.

FASB Considers Amendments to FIN 46(R) and FAS 140

The FASB is considering the issuance of additional guidance for determining the primary beneficiary in a variable interest entity. Included in this consideration is the purpose and design of a variable interest entity including the risks of the entity that pass through to interest holders. A staff discussion document covering this FASB project is available by clicking here.

In addition, the Board has been reconsidering a 2005 exposure draft that would amend FAS 140 and will consider removing the concept of Qualified Special Purpose Entities (QSPEs) from FAS 140 and removing the scope exception for QSPEs from Interpretation 46(R). Moreover, the Board is considering the issuance of guidance on accounting for transfers of financial assets to QSPEs and is considering significant enhancements to the disclosure requirements for this accounting. Further information regarding the FASB's current considerations of this matter is available by clicking here. In addition, a related staff discussion paper is available at the link provided above.

NAREIT will form a task force to consider the exposure draft that is scheduled to be issued this summer. If you would like to participate in this task force, please contact George Yungmann at gyungmann@nareit.com.

NAREIT Submits Comments on behalf of REESA to the IASC Foundation on XBRL

In May 2008, NAREIT submitted a comment letter on behalf of the Real Estate Equity Securitization Alliance (REESA) to the International Accounting Standards Committee (IASC) Foundation on the XBRL IFRS taxonomy. Click here to read the letter. REESA includes the following organizations: 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; and Property Association of Canada, REALPac.

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The most important recommendation to the IASC Foundation is that it should offer industry specific taxonomies, particularly a real estate taxonomy. NAREIT also submitted several specific comments on the taxonomy directly to the International Accounting Standards Board (IASB), suggesting the creation of additional line items for fair value adjustments to investment property, gains/losses on derivatives and net operating income.

In June 2008, the IASC Foundation published a final version of the taxonomy, which did not include NAREIT's recommendation for industry specific taxonomies. NAREIT is following up with the IASC Foundation to understand prospects for the implementation of industry specific taxonomies in the future. To learn more about the XBRL taxonomy, visit the IASB website at http://www.iasb.org/xbrl.

SEC Approves One-Year Deadline Extension for Small Business Section 404 Audit Compliance

In June, the SEC approved a one-year extension of the compliance date for smaller public companies, or non-accelerated filers who represent companies with a public float of less than $75 million, to meet the requirements of Section 404(b) of the Sarbanes-Oxley Act. Section 404(b) requires an auditor's attestation report on internal control over financial reporting. As a result of the new rule, a non-accelerated filer must file the Section 404(b) auditor's report when it files annual reports for fiscal years ending on or after Dec. 15, 2009.

The SEC also announced that it received approval from the Office of Management and Budget (OMB) to proceed with data collection for a study of the costs and benefits of Section 404 implementation, focusing on the consequences for smaller companies and the effects of the Section 404(b) auditor attestation requirements. The results of the study are expected to become available during the extension period. For more information on the rule, click here.

Upcoming 2008 NAREIT Financial Standards Events

Internal Audit Forum

The 2008 Internal Audit Forum will be held on Aug. 5 and 6 in Philadelphia, Pennsylvania. The event will be hosted by: Brandywine Realty Trust, Liberty Property Trust and Pennsylvania Real

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Estate Investment Trust. Attendance at the Internal Audit Forum is by invitation only and the program

has been designed specifically for internal audit directors or other senior level financial professionals responsible for internal audit. This annual event has proven to be successful in providing useful information toward enhancing the effectiveness of the internal audit function. For registration information, please contact KC Ellis at kellis@nareit.com or (202) 739-9402.

Retail Sector Operations Accounting Forum

Taubman Centers, Inc. and Ramco-Gershenson Properties Trust will sponsor the third annual Retail Sector Operations Accounting Forum, which will be held on Aug. 13 and 14 in Detroit, Michigan. The program offers best practice guidelines for the retail sector and provides a forum for participants to share industry practices. The program will also include a presentation of major impacts of adopting IFRS on operations accounting. To register for this event, please contact KC Ellis at kellis@nareit.com or (202) 739-9402.

Senior Financial Officers/Investor Relations Officers Workshop

NAREIT's 2008 Senior Financial Officers/Investor Relations Officers Workshop will be held on Sept. 22 and 23 in New York City. Attendance at this program is by invitation only. The workshop is specifically designed for senior officers in the fields of accounting, financial reporting, capital markets, insurance and investor relations. The workshop provides attendees with opportunities to understand and discuss the latest developments and trends impacting the financial management of real estate companies. Please contact KC Ellis at kellis@nareit.com or (202) 739-9402 for registration information. Registration materials are currently being distributed.

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