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NAREIT Financial Standards Update

National Association of Real Estate Investment Trusts®
REITs: Building Dividends and Diversification®

Highlights

- NAREIT Task Forces In Formation - Pg.1
- SEC Releases Proposed Roadmap for Mandatory IFRS Adoption in 2014 - Pg.1
- FASB and IASB Issue Proposal on Financial Statement Presentation - Pg.3

NAREIT Task Forces In Formation

This *Financial Standards Update* discusses, among other news, three proposals that could have significant long-term impact on financial reporting by NAREIT member companies. The proposals include: 1) the Securities and Exchange Commission (SEC) proposal for mandatory adoption of International Financial Reporting Standards (IFRS); 2) the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) preliminary views with respect to the *Financial Statement Presentation* Project; and, 3) the FASB and IASB proposal that would modify the accounting and reporting for discontinued operations. Please consider joining the task forces, discussed further below, that will evaluate these proposals and support the development of NAREIT's comment letters.

SEC Releases Proposed Roadmap for Mandatory IFRS Adoption in 2014

On Nov. 14, 2008, the SEC released a proposed roadmap that would, if certain milestones are reached, result in all U.S. issuers preparing their financial statements under IFRS as issued by the IASB beginning in 2014.

The proposed multi-year roadmap outlines seven milestones. Milestones 1 - 4 would need to be addressed to the SEC's satisfaction before mandatory IFRS adoption:

1. improvements to IFRS;
2. accountability and funding of the International Accounting Standards Committee Foundation, the governing body of the IASB;
3. improvement in the ability to use eXtensible Business Reporting Language (XBRL) in IFRS filings; and,
4. education and training of IFRS in the U.S.

Milestones 5 - 7 discuss the transition plan for the mandatory use of IFRS:

5. limited early use of IFRS when this would enhance comparability for U.S. investors (see key dates below under 2009 for more information);
6. anticipated timing of future rulemaking by the SEC – based on the progress made on milestones 1 - 4 and experience gained from milestone 5,

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the SEC will determine in 2011 whether to require mandatory IFRS adoption for all U.S. issuers; and,

7. implementation of mandatory use of IFRS by U.S. issuers – transition to IFRS to occur in stages as noted in the key dates below under 2014 - 2016.

Key dates in the roadmap proposal include:

2009: A limited group of U.S. issuers could begin voluntary IFRS filings for fiscal years ending on or after Dec. 15, 2009. This limited group would be among the 20 largest listed companies worldwide within an industry group by market capitalization that use IFRS as the basis of financial reporting more than any other set of standards. An issuer would apply an industry classification scheme, such as the Standard Industrial Classification (SIC) codes at the two-digit level, to determine its industry group. A Deloitte study has concluded that a number of NAREIT member companies may qualify for early IFRS adoption.

To apply, U.S. issuers would submit their analysis in determining their eligibility for limited early use of IFRS to the Division of Corporation Finance staff. If the staff has no objections to the issuer's conclusion of eligibility for early IFRS adoption, a letter of no objection would be issued and would provide an issuer with the ability to commence IFRS filings for a period of three years from the date of the staff response. The letter would not commit the eligible IFRS issuer to use IFRS.

The first-time IFRS filings by early adopters would be limited to annual reports. First-time IFRS filings would disclose certain information relating to the decision to change to IFRS and provide three years of audited IFRS financial statements, including the reconciliation and disclosure requirements in IFRS 1, *First-time Adoption of IFRS*.

Early IFRS adopters would not be required to file financial statements under U.S. Generally Accepted Accounting Principles (GAAP) in addition to IFRS filings. First-time IFRS adopters would provide the reporting requirements under IFRS 1, which include reconciliations from U.S. GAAP to IFRS of equity at the date of transition and at the end of the latest period presented in the most recent U.S. GAAP annual financial statements. Under IFRS 1, an early adopter would also provide a reconciliation from U.S. GAAP to IFRS of its total comprehensive income for the latest period in the most recent U.S. GAAP annual financial statements, as well as explanations for material adjustments to the statement of cash flows.

In the proposal, the SEC offers another alternative for the disclosure of U.S. GAAP information that, in addition to the aforementioned reconciliations, would require unaudited reconciliations from IFRS to U.S. GAAP covering a three-year period for the annual IFRS financial statements on an ongoing basis. Click here to refer to the SEC proposal.

The roadmap identifies several proposed amendments to existing SEC rules and forms that would allow the limited early use of IFRS, including the addition of Article 13 to Regulation S-X that would specifically apply to IFRS financial statements that are filed by U.S. issuers. The proposed roadmap also clarifies that certain rules would continue to apply to IFRS financial statements such as Article 11, *Pro Forma Financial Information* and Article 12, *Form and Content of Schedules*, while other rules such as Article 10, *Interim Financial Statements* would no longer apply.

2011: The SEC is expected to finalize its decision of whether or not to mandate IFRS adoption.

2014 - 2016: Mandatory IFRS adoption would be implemented on a phased-in approach for U.S.

issuers starting in 2014. IFRS filings would begin for large accelerated filers for fiscal years ending on or after Dec. 15, 2014. Other accelerated filers would begin IFRS filings for years ending on or after Dec. 15, 2015. Non-accelerated filers, including smaller companies, would begin IFRS filings for years ending on or after Dec. 15, 2016.

The SEC requests comments on various issues proposed in the roadmap, including but not limited to: the timing and implementation of the transition to IFRS; significant issues that the SEC should evaluate in assessing whether IFRS is sufficiently comprehensive; alternatives in providing U.S. GAAP information in IFRS filings for early adopters; and, consideration of the current application of Regulation S-X and Regulation S-K to IFRS financial statements. Click here to access the SEC proposal.

Comments on the proposal are due by Feb. 19, 2009. If you are interested in joining a task force to assist in the preparation of NAREIT's comment letter on this SEC proposal, please contact George Yungmann at gyungmann@nareit.com.

FASB and IASB Issue Proposal on Financial Statement Presentation

After three years of research and debate, on Oct. 16, 2008, both the FASB and IASB released a Preliminary Views Document (PVD) on the *Financial Statement Presentation* Project. The objectives of this project are to portray a cohesive financial picture of an entity's activities, disaggregate information so that it is useful in predicting an entity's future cash flows and help users assess an entity's liquidity and financial flexibility. The new presentation would link data across the financial statements to provide a clear, consistent flow of interrelated information, and apply a "management approach" to the classification of financial statement items to convey to users the manner in which an entity views its activities. This presentation format also is intended to provide users with information about the way an entity creates value through its business activities separately from the way it funds those business activities through its financing activities.

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To accomplish these objectives, the Boards propose the classification of all financial statement items into the following major categories: business, financing, income taxes and discontinued operations. An additional category for equity would be included in the statements of financial position and cash flows.

Classification of assets and liabilities into these categories in the statement of financial position would determine the classification of elements in the statements of comprehensive income and cash flows. Management would be responsible for classification decisions and the rationale behind the decisions would be disclosed as an accounting policy in the financial statement notes. Additionally, the PVD requires a new schedule in the notes that reconciles cash flows to comprehensive income on a line by line basis. The PVD is available by clicking here.

As previously reported, NAREIT and its global partners of the Real Estate Equity Securitization Alliance (REESA) have developed a real estate financial statement model in response to this joint FASB and IASB project. For more information on this model, click here. REESA will use the approved global model as a basis for commenting on the PVD. Comments are due by Apr. 14, 2009. NAREIT is establishing a task force to evaluate the PVD and develop NAREIT's views. If you would like to participate on this task force, please contact George Yungmann at gyungmann@nareit.com.

FASB Removes Fair Value of Investment Property from its Agenda

In October 2008, FASB dropped the *Fair Value Option – Phase 2, Investment Property* Project from its short-term convergence projects agenda. In this project, the FASB was to examine reporting investment property at fair value, similar to reporting under International Accounting Standard No. 40, *Investment Property.* This standard provides an option to report investment property at depreciated cost or fair value. NAREIT believes this recent decision was based on the following factors: 1) the current controversy about reporting financial instruments at fair value and its potential impact on the current credit crisis; 2) the apparent appeal to the SEC to "suspend work on any project that would require fair value in any future accounting standard"; 3) the conflicting opinions from users of the industry's financial statements as to the usefulness of reporting the fair value of investment property; and, 4) the recommendation from the SEC's Committee to Improve Financial Reporting that financial standards should not provide optional accounting.

As a result of FASB removing this project from its agenda, the reporting of investment property at fair value will most likely resurface in connection with the potential mandatory IFRS adoption in the U.S. beginning in 2014.

FASB AND IASB Propose Converged Definition of Discontinued Operations

On Sept. 25, 2008, both the FASB and IASB issued proposed amendments to standards that set forth the accounting and reporting for discontinued operations. The proposed amendments reflect a converged definition of a discontinued operation that, for certain NAREIT member companies, would result in reporting fewer dispositions as discontinued operations. Developing a global harmonized definition was suggested by NAREIT in its July 17, 2006 letter to the FASB. To read the letter, click here.

In FASB Staff Position (FSP) Financial Accounting Standard 144-d, the FASB proposes that a discontinued operation is a component of an entity that is: a) an *operating segment* (as defined in FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*) and either has been disposed of or is classified as held for sale; or, b) a *business* (as defined in FASB Statement No. 141(R), *Business Combinations*) that meets the criteria to be classified as held for sale ***on acquisition***. To access the FSP, click here.

In addition to redefining a discontinued operation, the proposed amendments set forth disclosure requirements for a component of an entity that either has been disposed of or is classified as held for sale – whether or not reported as a discontinued operation. The proposed amendments would be effective for fiscal years beginning after Dec. 15, 2009 and interim periods within those fiscal years, with early application permitted. The modified reporting would be applied retrospectively.

NAREIT and its REESA global partners intend to comment on the proposed amendments. Comments are due by Jan. 23, 2009. If you would like to participate in NAREIT's consideration of the Boards' proposed modifications and in the development of a comment letter, please contact George Yungmann at gyungmann@nareit.com.

NAREIT Opposes FASB's Proposed Amendments in FIN 46(R)

The FASB issued a proposal, *Amendments to FASB Interpretation No. 46(R)*, that would modify the criteria to determine whether to consolidate a variable interest entity (VIE), introduce ongoing assessments of VIEs and primary beneficiaries, and require additional disclosures. The objective of the proposal is to improve financial reporting for entities with VIEs and eliminate the exceptions that consider the consolidation of qualifying special purpose entities. The exposure draft is available by clicking here.

On Nov. 14, 2008, NAREIT submitted a comment letter that presented the negative impacts that the proposed accounting would have on the accounting for jointly owned entities. These impacts included: the inconsistent consolidation or deconsolidation conclusions for similar entities due to conflicting treatment of substantive kick-out rights and differing interpretations of the term "power to direct" in the determination of a primary beneficiary; the impracticality, as well as increased effort and costs, in performing ongoing assessments of VIEs and primary beneficiaries; and, the unintended consequence of deconsolidating real estate joint ownership arrangements. Click here to access NAREIT's comment letter.

2009 REITWise™: NAREIT's Law, Accounting and Finance Conference

REITWise™, the new name for NAREIT's Law, Accounting and Finance Conference, will be held at La Quinta Resort & Club in La Quinta, California on March 25 through 27, 2009. The Conference provides both general and technical educational sessions about legal, accounting, finance and tax topics for REITs and real estate companies. The Conference also offers members with opportunities to network with colleagues and exchange information about the latest trends and changes occurring in our industry. More detailed information regarding the agenda and registration will be distributed in January and will be available on REIT.com™.

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