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July 14, 2014

Ms. Susan Cosper  
Technical Director  
File Reference No. 2014-200  
Financial Accounting Standards Board  
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**Delivered Electronically**

**Re: File Reference No. 2014-200, Exposure Draft: *Conceptual Framework for Financial Reporting, Chapter 8: Notes to Financial Statements***

Dear Ms. Cosper:

This letter is submitted by the National Association of Real Estate Investment Trusts® (NAREIT) in response to the Financial Accounting Standards Board's (FASB or the Board) *Exposure Draft: Conceptual Framework for Financial Reporting, Chapter 8: Notes to Financial Statements* (the Exposure Draft).

NAREIT is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other real estate businesses throughout the world that own, operate and finance commercial and residential real estate. NAREIT's members play an important role in providing diversification, dividends, liquidity and transparency to investors through their businesses that operate in all facets of the real estate economy.

REITs are generally deemed to operate as either Equity REITs or Mortgage REITs. Our members that operate as Equity REITs acquire, develop, lease and operate income-producing real estate. Our members that operate as Mortgage REITs finance housing and commercial real estate, by originating mortgages or by purchasing whole loans or mortgage backed securities in the secondary market.

A useful way to look at the REIT industry is to consider an index of stock exchange-listed companies like the FTSE NAREIT U.S. Real Estate Index, which covers both Equity REITs and Mortgage REITs. This Index contained 209 companies representing an equity market capitalization of \$783 billion at April 30, 2014. Of



these companies, 168 were equity REITs representing 91.2% of total U.S. listed REIT equity market capitalization (amounting to \$714 billion)<sup>1</sup>. The remainder, as of April 30, 2014, was 41 publicly traded mortgage REITs with a combined equity market capitalization of \$69 billion.

### **EXECUTIVE SUMMARY**

NAREIT supports the Board's objective to improve the effectiveness of disclosures in the notes to the financial statements by clearly and concisely communicating the information that is most relevant to users of financial statements. NAREIT further welcomes the potential benefit of reducing superfluous, duplicative and/or irrelevant disclosures as a consequence of a sharper focus on what users of financial statements value most in evaluating the prospects of future cash flows of public companies. However, we do not believe that the disclosure framework included in the Exposure Draft would achieve the project's objective. Rather than improving disclosure effectiveness and eliminating redundancy, we believe that the proposed framework could expand possible disclosure requirements significantly because it does not provide clear direction. Thus, we do not believe that the framework would prove operational for Board members as they develop disclosure requirements in future standards setting. NAREIT offers a number of recommendations that we believe would assist the Board in developing an effective and efficient disclosure framework.

### **NAREIT RECOMMENDATIONS**

Following are NAREIT recommendations that should assist the Board in developing an effective framework that would promote consistent decisions and the proper use of discretion by the Board:

- **Re-evaluate and reconcile the purpose of the Exposure Draft with the root cause that triggered the project**
- **Ensure that disclosures address each of the financial statements, not just the balance sheet**
- **Focus disclosure requirements on the elements of the financial statements, rather than financial statement line items only**
- **Coordinate efforts to address the problem of “disclosure overload” with the IASB**
- **Address materiality as a key element to the Exposure Draft**
- **Develop a financial reporting model that delineates which disclosures belong in the notes to the financial statements as opposed to MD&A**

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<sup>1</sup> <http://www.reit.com/sites/default/files/reitwatch/RW1405.pdf> at page 21.



- **Ensure that interim disclosures are not a mere repeat of the annual disclosures unless there is a material change**
- **Further engage and collaborate with all interested constituents, including regulators (i.e., the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB)), preparers, analysts, and auditors, in field testing of the revised Exposure Draft**

**Re-evaluate and reconcile the purpose of the Exposure Draft with the root cause that triggered the project**

NAREIT concurs with the Exposure Draft's explanation that "The primary purpose of notes to financial statements is to supplement or further explain the information on the face of financial statements by providing financial information relevant to existing and potential investors, lenders, and other creditors for making decisions about providing resources to the entity."<sup>2</sup> Further, NAREIT understands that the "objective and primary focus of this project is to improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each entity's financial statements."<sup>3</sup> However, NAREIT fears that the Board is not meeting the project's objective based on the contents of the Exposure Draft. Rather than adding specificity about the type of information that the Board would require in the notes, the Conceptual Framework "would identify, by design, a broad range of possibilities for the Board to consider when deciding on the disclosures related to a particular topic that is required under U.S. GAAP."<sup>4</sup> The Board would rely on individual standard-setting projects to then narrow the disclosure requirements.

Based on this approach, NAREIT has significant concern that the Exposure Draft provides Board members with a framework that would expand disclosure requirements, rather than narrowing the focus of disclosure to be both useful and relevant to users of financial statements. Such an unfettered approach would exacerbate future standard setting in continually starting from a wide-ranging view of potential disclosures where the sky is the limit, rather than focusing on the type of information that users of financial statements actually need. In our view, an underlying principle to the Conceptual Framework should be the consideration of decision-usefulness of information to users of financial statements at a reasonable cost before considering the infinite realm of potential disclosure. Without a holistic view of and a sound foundation for the purpose

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<sup>2</sup>[http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175828468314&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=424282&blobheadervalue1=filename%3DProposed\\_Concepts\\_Statement\\_CF\\_for\\_Financial\\_Reporting%25E2%2580%2594Chapter8-Notes\\_to\\_Financial\\_Statements.pdf&blobcol=urldata&blobtable=MungoBlobs](http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175828468314&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=424282&blobheadervalue1=filename%3DProposed_Concepts_Statement_CF_for_Financial_Reporting%25E2%2580%2594Chapter8-Notes_to_Financial_Statements.pdf&blobcol=urldata&blobtable=MungoBlobs) at page 5, par. S2.

<sup>3</sup>[http://www.fasb.org/cs/ContentServer?c=FASBContent\\_C&pagename=FASB%2FFASBContent\\_C%2FProjectUpdatePage&cid=1176156344894](http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FProjectUpdatePage&cid=1176156344894)

<sup>4</sup>[http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175828468314&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=424282&blobheadervalue1=filename%3DProposed\\_Concepts\\_Statement\\_CF\\_for\\_Financial\\_Reporting%25E2%2580%2594Chapter8-Notes\\_to\\_Financial\\_Statements.pdf&blobcol=urldata&blobtable=MungoBlobs](http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175828468314&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=424282&blobheadervalue1=filename%3DProposed_Concepts_Statement_CF_for_Financial_Reporting%25E2%2580%2594Chapter8-Notes_to_Financial_Statements.pdf&blobcol=urldata&blobtable=MungoBlobs) at page 3, par. P13.



of notes to the financial statements, the Board might perpetuate the piece-meal approach that has resulted in voluminous disclosure historically.

**Ensure that disclosures address each of the financial statements, not just the balance sheet**

In NAREIT's view, the Exposure Draft is driven by balance sheet disclosure. NAREIT observes that the Board should consider expanding the disclosure framework to include the income statement and the statement of cash flows. Based on feedback that we have received from users of financial statements, the information included in the income statement and statement of cash flows is critical for their financial analysis in developing valuations for our member companies. These valuations are the basis for buy or sell recommendations that impact capital allocation decision and ultimately have a direct impact on share price.

**Focus disclosure requirements on the elements of the financial statements, rather than financial statement line items only**

NAREIT recommends that the FASB refocus the Exposure Draft to view disclosure as an extension of the economics of transactions, rather than specific line items in the financial statements. NAREIT observes that the FASB has historically developed standards with transactions in mind (*e.g.*, leases and revenue recognition that are relevant to the real estate industry), rather than a focus on financial statement line items alone. A transaction and economics-based view of disclosure will place non-accountants on a level playing field to understand the implications on risk, volatility and the future prospects of a company resulting from elements of the financial statements.

**Coordinate efforts to address the problem of "disclosure overload" with the IASB**

NAREIT understands that the idea of enhancing and synthesizing disclosure requirements is not just a U.S. phenomenon. For example, the International Accounting Standards Board (IASB) recently commenced its own Disclosure Initiative that is intended to explore how disclosures in International Financial Reporting Standards can be improved. In a speech titled "Breaking the Boilerplate," Chairman Hans Hoogervorst stated that "For many companies, the size of their annual report is ballooning. The amount of useful information contained within those disclosures has not necessarily been increasing at the same rate. The risk is that annual reports become simply compliance documents, rather than instruments of communication."<sup>5</sup>

Especially in light of recent remarks made by Securities and Exchange Commission Chairman Mary Jo White<sup>6</sup> in reference to the future possibility of IFRS reporting in the U.S., NAREIT believes it would be prudent for the FASB to coordinate its efforts toward developing a disclosure framework in conjunction with the IASB's efforts on its Principles of Disclosure. These efforts would potentially reduce disclosure requirement gaps between U.S. GAAP and

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<sup>5</sup> <http://www.ifrs.org/Alerts/Conference/Documents/2013/HH-Amsterdam-June-2013.pdf>

<sup>6</sup> <http://www.iasplus.com/en/news/2014/05/sec-speech>



IFRS in future standard setting, which could be especially useful to issuers who need to file both in the United States and in IFRS jurisdictions.

### **Address Materiality as a key element to the Exposure Draft**

The FASB might also benefit from collaboration with the IASB on the materiality phase of the IASB's Disclosure Initiative. While the FASB has not considered materiality in the Exposure Draft, the IASB is currently researching how materiality is utilized in preparing financial statements. In NAREIT's view, the FASB should evaluate how the consideration of a materiality principal would enhance future disclosure requirements. We recognize that developing materiality thresholds for disclosure is somewhat abstract and challenging from a qualitative perspective. However, absent a consideration of materiality in the Exposure Draft, preparers will be faced with proving why disclosure is not material to auditors and the Public Company Accounting Oversight Board (PCAOB). In our view, preparers may not believe that reducing disclosure for materiality sake is worth the time, effort, and level of second-guessing to be endured. As a result, preparers may simply default to the "check-list" safe-harbor approach to disclosure that has developed in the U.S. over time.

### **Develop a financial reporting model that delineates which disclosures belong in the notes to the financial statements as opposed to Management's Discussion and Analysis (MD&A)**

NAREIT is concerned that new disclosures that are *prospective* in nature and akin to financial analysis would be required to be included in the notes to the financial statements. Today, information typically included within the financial statements is primarily *historical*, while *forward-looking* information is generally included in MD&A. Beyond NAREIT's concern that blending financial analysis with historical information embedded in the notes to financial statements would cause confusion to financial statement users, NAREIT questions whether audit firms would be able to render unqualified audit reports on financial statements that include this information.

NAREIT suggests that the Board develop a model that delineates which disclosures belong in the notes to the financial statements as opposed to MD&A. One possible way of accomplishing this would be to develop a principle that historical information is included within the financial statements, while forward looking information is generally included in MD&A. In so doing, NAREIT suggests that the FASB work with the SEC in studying existing disclosure requirements in the notes to financial statements and in MD&A and **seek to eliminate redundancies**.

In order to effectuate a financial reporting model that clearly requires historical information in the financial statements and forward-looking information in MD&A, NAREIT suggests that the Board move the following paragraph from the Basis for Conclusions (*i.e.*, paragraph BC16) to the forefront of the "Future-Oriented Information" section of the final conceptual framework:

[A]lthough disclosures may be oriented toward the future, the information in those disclosures is appropriate if it is either dictated by a current known condition or



embedded within a current measurement used within the financial statements. Furthermore, expectations and assumptions about the future that were not within a current measurement would not be appropriate for requirement in notes.<sup>7</sup>

**Ensure that interim disclosures are not a mere repeat of the annual disclosures unless there is a material change**

NAREIT has observed a growing trend in accounting pronouncements that requires companies to prepare the same types of disclosures at both interim and annual reporting dates. NAREIT questions whether detailed information can continue to be disclosed at interim periods given shorter quarterly SEC financial reporting deadlines (*i.e.*, 40 days for both large accelerated filers and accelerated filers, and 45 days for non-accelerated filers<sup>8</sup>) when compared with annual SEC financial reporting deadlines (*i.e.*, 60 days for large accelerated filers, 75 days for accelerated filers, and 90 days for non-accelerated filers).<sup>9</sup> In NAREIT's view, each interim period is an integral part as opposed to a discrete part of the annual reporting period. Therefore, NAREIT suggests that the Board consider the approach that the SEC utilizes for material changes in financial condition and quantitative and qualitative disclosures of market risks. The SEC requires these disclosures in annual reports. To the extent that there has been a material change since the date of the most recent annual report, the SEC requires disclosures in quarterly filings as well. By taking this approach, the SEC has effectively incorporated both relevant and meaningful disclosure for interim reporting periods, while eliminating duplicative disclosure. NAREIT believes that the FASB could achieve its objective by taking a similar approach.

**Further engage and collaborate with all interested constituents, including regulators (*i.e.*, the SEC and the PCAOB), preparers, analysts, and auditors, in field testing of the revised Exposure Draft**

In order to increase the likelihood of the success of the project, NAREIT believes that it would be prudent for the Board to further engage and collaborate with all interested constituents in the process of field testing the revised Exposure Draft by preparing and evaluating "real life" examples of financial statements. Without obtaining the perspectives of all interested parties at the forefront, the Board runs the risk of having preparers default to a check list of disclosure requirements so as to reduce the possibility of being second-guessed by auditors and regulators. While NAREIT understands that many preparers and auditors take comfort in knowing that they complied with the "letter of the law" by following rules and ensuring compliance with the said rules through the use of check-lists, the success of this project hinges on a fundamental change in mindset amongst *all* constituents. By obtaining consensus at the commencement of the project,

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<sup>7</sup>[http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175828468314&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=424282&blobheadervalue1=filename%3DProposed\\_Concepts\\_Statement\\_CF\\_for\\_Financial\\_Reporting%25E2%2580%2594Chapter8-Notes\\_to\\_Financial\\_Statements.pdf&blobcol=urldata&blobtable=MungoBlobs](http://www.fasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175828468314&blobheader=application%2Fpdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=424282&blobheadervalue1=filename%3DProposed_Concepts_Statement_CF_for_Financial_Reporting%25E2%2580%2594Chapter8-Notes_to_Financial_Statements.pdf&blobcol=urldata&blobtable=MungoBlobs) at page 39.

<sup>8</sup><http://www.sec.gov/answers/form10q.htm>

<sup>9</sup><http://www.sec.gov/answers/form10k.htm>



Ms. Susan Cospers

July 14, 2014

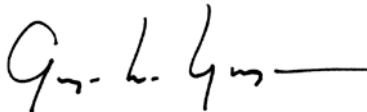
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there would be significantly less probability that current extensive disclosures are simply carried forward into the future. NAREIT would welcome the opportunity to participate in field testing and in coordinating a broad spectrum of constituents from the preparer, auditor, and financial statement user community focused on the real estate sector.

\* \* \* \*

We thank the FASB for the opportunity to comment on the Exposure Draft. If you would like to discuss our views in greater detail, please contact George Yungmann, NAREIT's Senior Vice President, Financial Standards, at [gyungmann@nareit.com](mailto:gyungmann@nareit.com) or 1-202-739-9432, or Christopher Drula, NAREIT's Vice President, Financial Standards, at [cdrula@nareit.com](mailto:cdrula@nareit.com) or 1-202-739-9442.

Respectfully submitted,



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