# Implications of IFRS for the U.S. Timber Industry: Plum Creek Timber and Brookfield Timberlands*

> *"We believe the implementation of IFRS for Plum Creek will be costly, significantly lower the quality of our financial reporting and we believe that the reported fair value of standing timber at the end of each quarter in accordance with IAS 41 may bear no close relationship to the ultimate selling price for our trees."* Plum Creek Timber[1]

> *"While we accept that the adoption of IFRS will lead to the addition of some modest cash costs and may lead to some confusion at the outset, we believe that the greater transparency provided by the presentation of reasonable fair value estimates outweighs these disadvantages."* Brookfield Timberlands[2]

In 2009, U.S. timber companies were wrestling with the implications of the forthcoming shift from U.S. Generally Accepted Accounting Principles (US GAAP) to International Financial Reporting Standards (IFRS). Of particular concern was the requirement to apply fair values to forestland with standing timber that could be harvested in the future. The relevant accounting guidance under IFRS was International Accounting Standard No. 41 (IAS 41, Exhibit 1), which specified that agricultural crops be valued at their fair market value less estimated harvesting costs at the end of each quarter. Given the standard was arguably developed for annual crops such as citrus or vegetables, some firms in the U.S. timber industry argued that valuing standing timberland was much more complex given the variety of ages, species and costs to harvest the timber. A Brookfield Timberlands report stated "The subjectivity involved in establishing timber value will cause significant heartburn for timber company managers and auditors."[3]

In 2009, Plum Creek Timber and Brookfield Timberlands made public statements on IAS 41 but reached opposing conclusions as indicated by the opening quotes in the case.

*Plum Creek Timber Company*

In 2010, Plum Creek Timber was the largest private timberland owner in the United States with approximately 7 million acres of forestland located in every significant timber region of

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* Robert Bowen and Jane Kennedy prepared this case using publicly available sources with the assistance of Frank Hodge and D. Shores. Public sources were used. Any reference to management actions or motives is purely hypothetical. Funding was provided by a PricewaterhouseCoopers IFRS Ready Grant. Revised, May 27, 2010.

[1] From May 24, 2009 letter to the Securities and Exchange Commission from Plum Creek Senior VP and CFO, David Lambert, p. 8.

[2] From First quarter 2009 Research Report on International Financial Reporting Standards: A North American Perspective" by Brookfield Asset Management, p. 4.

[3] Ibid, p. 2.

the country. Plum Creek was listed on the New York Stock Exchange (NYSE stock ticker PCL) and was part of several indices including the S&P 500, Russell 1000, Wilshire 5000 and Dow Jones Sustainability World index.

On March 24, 2009, David Lambert, Senior VP and Chief Financial Officer of Plum Creek, emailed a letter to the Securities and Exchange Commission (Exhibit 2) arguing that adoption of fair value reporting under International Accounting Standard No. 41 (IAS 41) would be both costly and lower the quality of the company's financial reporting. Arguments in the letter included:

- Fair value estimates of standing timber would be unreliable for accounting purposes
- Reporting of fair value estimates will harm comparability between companies
- U.S. capital markets have not accepted fair value reporting for non-financial assets
- Cost to estimate fair values on a quarterly basis will far exceed any benefits

Mr. Lambert's letter was unequivocal in its opposition to the standard being applied to Plum Creek and other U.S. timber companies.

*Brookfield Timberlands Management LP*

Brookfield Timberlands Management, a wholly owned subsidiary of Brookfield Asset Management, had approximately 2.5 million acres of forestland in North and South America. Brookfield Asset Management was listed on the New York Stock Exchange (NYSE stock ticker BAM).

Brookfield Timberlands issued a report in the first quarter of 2009 that presented arguments both for and against reporting standing timberlands at fair value (Exhibit 3). In the end, the report supported IAS 41 for U.S. timber companies concluding that "adoption of IFRS [is] an overall net positive for timberlands investors."

*Decision to Adopt IFRS?*

In 2010, as timber company managers continued to review IAS 41 (Exhibit 1), the following practical questions likely arose in the discussions:

- Does U.S. GAAP adequately capture the importance and value of standing timber for U.S. companies?
- Should standing timber be recorded at fair value?
- Will investors overreact to the natural swings in the value of timber and thus the fair value of standing timber?

Would you recommend that timber companies value their standing timber at fair value? Is it cost-effective for companies, auditors and/or investors? What position would you take on lobbying for the implementation of IFRS in the U.S.?

Exhibit 1

**Excerpts from International Accounting Standard #41 (IAS 41), Agricultural**

**Objective of IAS 41**

The objective of IAS 41 is to establish standards of accounting for agricultural activity – the management of the biological transformation of biological assets (living plants and animals) into agricultural produce (harvested product of the entity's biological assets).

**Key Definitions**

Biological assets: living animals and plants. [IAS 41.5]

Agricultural produce: the harvested product from biological assets. [IAS 41.5]

Costs to sell: incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. [IAS 41.5]

**Initial Recognition**

An entity should recognise a biological asset or agriculture produce only when the entity controls the asset as a result of past events, it is probable that future economic benefits will flow to the entity, and the fair value or cost of the asset can be measured reliably. [IAS 41.10]

**Measurement**

Biological assets should be measured on initial recognition and at subsequent reporting dates at fair value less estimated costs to sell, unless fair value cannot be reliably measured. [IAS 41.12]

Agricultural produce should be measured at fair value less estimated costs to sell at the point of harvest. [IAS 41.13] Because harvested produce is a marketable commodity, there is no 'measurement reliability' exception for produce.

The gain on initial recognition of biological assets at fair value less costs to sell, and changes in fair value less costs to sell of biological assets during a period, are reported in net profit or loss. [IAS 41.26]

A gain on initial recognition of agricultural produce at fair value less costs to sell should be included in net profit or loss for the period in which it arises. [IAS 41.28]

All costs related to biological assets that are measured at fair value are recognised as expenses when incurred, other than costs to purchase biological assets.

IAS 41 presumes that fair value can be reliably measured for most biological assets. However, that presumption can be rebutted for a biological asset that, at the time it is initially recognised in financial statements, does not have a quoted market price in an active market and for which other methods of reasonably estimating fair value are determined to be clearly inappropriate or unworkable. In such a case, the asset is measured at cost less accumulated depreciation and impairment losses. But the entity must still measure all of its other biological assets at fair value less costs to sell. If circumstances change and fair value becomes reliably measurable, a switch to fair value less costs to sell is required. [IAS 41.30]

Exhibit 1 (continued)

**Excerpts from International Accounting Standard #41 (IAS 41), Agricultural**

The following guidance is provided on the measurement of fair value:

- a quoted market price in an active market for a biological asset or agricultural produce is the most reliable basis for determining the fair value of that asset. If an active market does not exist, IAS 41 provides guidance for choosing another measurement basis. First choice would be a market-determined price such as the most recent market price for that type of asset, or market prices for similar or related assets [IAS 41.17-19]
- if reliable market-based prices are not available, the present value of expected net cash flows from the asset should be use, discounted at a current market-determined rate [IAS 41.20]
- in limited circumstances, cost is an indicator of fair value, where little biological transformation has taken place or the impact of biological transformation on price is not expected to be material [IAS 41.24]
- the fair value of a biological asset is based on current quoted market prices and is not adjusted to reflect the actual price in a binding sale contract that provides for delivery at a future date [IAS 41.16]

**Other Issues**

The change in fair value of biological assets is part physical change (growth, etc.) and part unit price change. Separate disclosure of the two components is encouraged, not required. [IAS 41.51]

Fair value measurement stops at harvest. IAS 2, Inventories, applies after harvest. [IAS 41.13]

Agricultural land is accounted for under IAS 16, Property, Plant and Equipment. However, biological assets that are physically attached to land are measured as biological assets separate from the land. [IAS 41.25]

Intangible assets relating to agricultural activity (for example, milk quotas) are accounted for under IAS 38, Intangible Assets.

Source: http://www.iasplus.com/standard/ias41.htm

Exhibit 2

**Plum Creek letter to the SEC**

PlumCreek

March 24, 2009

VIA E-MAIL DELIVERY TO: rule-comments@sec.gov

Ms. Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

**RE: File No. S7-27-08, Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers**

Dear Ms. Murphy:

Plum Creek appreciates the opportunity to provide its views on *File No. S7-27-08, Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*. Plum Creek Timber Company, Inc. ("Plum Creek") is a publicly-traded Real Estate Investment Trust, and is the largest private landowner in the United States with over 7 million acres of timberlands.

Plum Creek supports the goal of high-quality financial reporting and agrees with the Commission that financial reporting is typically enhanced by improvements in the relevance, reliability and comparability of the information reported. However, we believe the adoption of International Financial Reporting Standards ("IFRS") by Plum Creek will result in a significant decline in the quality of our financial reporting. We are concerned primarily with the provisions of *International Accounting Standard ("IAS") No. 41, Agriculture*, and the requirement to report our standing timber at fair value at the end of each quarter, with changes in fair value reported in operating income.

IAS 41 is the international accounting standard applicable to agricultural products, including standing timber. IAS 41 requires standing timber to be reported at fair value less estimated point-of-sale costs at the end of each quarter, unless fair value cannot be measured reliably. Quarterly changes in fair value are reported in operating income. If fair value cannot be measured reliably, agricultural products are reported at depreciated cost less accumulated impairment losses.

Under IAS 41, there is a presumption that the fair value of all agricultural products can be measured reliably. This presumption can only be rebutted upon initial recognition. We believe based on discussions with several public accounting firms, that upon our adoption of IFRS, we will be required to report our standing timber at fair value unless we are granted an exemption by the Commission. Therefore, we are commenting on the SEC's proposal in an effort to express

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 2**

our views that fair value accounting for standing timber will significantly lower the quality of our financial reporting. In addition to our concern that reporting standing timber at fair value is not reliable within an acceptable range, we are also concerned:

- that the marketplace has not accepted fair value accounting for non-financial assets,
- that reporting our standing timber at fair value will not improve comparability, and
- that the cost to determine the fair value of our standing timber on a quarterly basis will be excessive and will far outweigh any benefits of reporting under IFRS.

Additionally, however to a lesser extent, we are concerned about the reporting of investment property under IAS No. 40, *Investment Property*. Under IAS 40, investment property is defined as property held for either rental income or capital appreciation. IAS 40 allows investment property to be accounted for at either cost or fair value. However, if the cost method is elected, the fair value of the investment property must be disclosed in the notes to the financial statements. We believe a significant portion of our timberlands will be accounted for as investment property under IAS 40. Furthermore, similar to standing timber, we believe the reporting of investment property at fair value is not reliable within an acceptable range.

**Fair Value Estimates of Standing Timber Are Not Reliable for Accounting Purposes**

We agree that fair value accounting is more relevant than historical cost accounting. However, we also believe that the more assumptions that are required in determining fair value, the less reliable the reported amounts tend to be. In addition, we believe that at some point the decline in reliability due to the need for significant estimates will outweigh the benefits of more relevant information. As a result, high-quality financial reporting is compromised.

We believe estimating the fair value of standing timber requires numerous and extensive assumptions. For all but mature timber stands (which are currently available to harvest), the fair value of standing timber is determined using the discounted cash flow model. There are no market prices available for partially grown stands of timber. We believe the fair value of partially grown stands is therefore theoretical and cannot be objectively determined. Furthermore, because our growing cycles range from 25 years in the South to over 50 years in the North, partially grown stands comprise over 90% of our total timber inventory.

Additionally, there are no national markets for mature timber. Prices for mature timber are based on local markets and will vary significantly from stand to stand based on many attributes including species mix, stocking levels, topography, and distance to market. As a result of each stand's unique characteristics, a company-wide fair value estimate of our mature timber will be difficult and time consuming.

In our view, the key assumptions that will be used in determining the fair value of standing timber based on the discounted cash flow model are: (1) future log prices, (2) future operating costs, (3) current standing timber inventory, (4) growth rates, (5) discount rate and (6) the cost of fertilizer. Furthermore, underlying each key assumption is a myriad of other assumptions. For example, any discount rate assumption would be based on estimates regarding the risk-free rate

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 3**

of interest, the spread between the risk-free rate and a high quality corporate bond rate and the risk premium for equity securities.
Similarly, there are numerous assumptions underlying our estimate of future log prices. For example, our estimates include our assumptions regarding inflation, interest rates, demographics and population growth, the strength of the U.S. and world-wide economies, demand for paper products, housing starts, timber harvest levels in the U.S. and Canada and currency exchange rates.

Additionally, it is standard industry practice to sample only a portion of your timber each year as a part of updating the statistical estimate of your standing timber inventory. Annually, we cruise approximately 10% of our standing inventory. Timber cruises (an estimate of timber volume and quality in a stand based on sample plots) are used to update our standing inventory for changes due to: growth; natural disasters such as fire, insect infestation and disease; and harvesting activity. We believe that we have one of the best timber inventory systems in the industry and our estimates are reasonable and statistically reliable within a 95% confidence level. However, we also believe based on existing technology that it is cost prohibitive to increase the confidence level of our standing inventory estimates. Therefore, as a result of this update process, our statistical estimate of timber inventory can increase or decrease by several percentage points annually within the reasonable sampling margin of error. This point estimate of our standing inventory could significantly impact the fair value estimate of our standing timber without representing a statistical change in our inventory.

Another example of a key estimate that can have a significant impact on the fair value of standing timber relates to transportation costs. IAS 41 requires agricultural products to be measured at fair value less transportation and other costs of getting the product to market. It is not uncommon in our industry for logging and hauling costs to represent over 50% of the value of a delivered log. Estimates regarding future log and haul costs are impacted by our estimates of: future oil prices; the availability of loggers; and the distance between our timber stands and our customers, which in turn is dependent upon our estimate of future mill closures and capacity expansions.

Furthermore, we believe that the greater the time periods to be included in the fair value estimate, the less reliable the estimate tends to be. IAS 41 applies to all agricultural products regardless of the time from planting to harvesting. Many agricultural products are harvested annually. However, standing timber harvest rotations can be as long as 90 years. In the Southern United States, sawlog rotations are approximately 25 years, while in the North they can exceed 50 years in many regions. The long term nature of our standing timber has a significant multiplying effect on our fair value estimates based on small changes in assumptions. In contrast, most agricultural crops have a short growing cycle, and therefore, fair value estimates are significantly less sensitive to assumption changes. We believe that with such long time horizons, it is impossible to estimate the fair value of standing timber with a level of accuracy that accountants will find acceptable or reliable.

In addition to the extensive number of estimates required to compute fair value, during the past several years we have experienced considerable volatility in the economic conditions impacting our timberlands. For example, we have evaluated timberland acquisitions using discount rates

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 4**

ranging from 7% to 12%. Sawlog prices in the South have ranged from $25/ton to $39/ton and pulpwood prices in the South have ranged from $7/ton to $12/ton. Fertilizer prices have ranged from $44/acre to $225/acre. Furthermore, due to the unique nature of each timber stand, growth rate projections can vary significantly. For example, growth rate projections in the South have ranged between 8% and 11%.

We estimate that over 50% of our enterprise value is derived from the value of our standing timber. As a result, we believe that small changes in the underlying assumptions can have a material impact on our reported earnings. For example, we estimate that a one-half percentage point change in our discount rate assumption will change the fair value of our standing timber by more than $100 million. Additionally, we estimate that a one-half percentage point change in our assumption regarding future log price appreciation will also change the fair value of our standing timber by more than $100 million. As mentioned above, IAS 41 requires changes in fair value to be reported in operating income. These estimated fair value changes of more than $100 million are material when compared to our average quarterly reported earnings during the past eight quarters of approximately $65 million.

Under IAS 41, the performance of our timber business will be measured based on the quarterly change in the fair value of our standing timber. In theory, the operating income from the harvest of timber will be close to zero since the timber will be recorded on our books at fair value and should approximate its net selling price. The harvesting and selling of timber will no longer be a significant financial event based on the financial reporting under IAS 41. Our performance will no longer be measured based on verifiable selling prices and cost of sales but will be based on changes to management's estimate of fair value. We believe our investors will not understand our reported earnings under IAS 41. They will have less confidence that our earnings are reported accurately; and therefore, they will require a higher risk premium associated with an investment in Plum Creek due to this increased uncertainty.

Therefore, we believe that small changes in estimates could have a material impact on our reported earnings. We also believe that any change in assumptions will be highly subjective, very difficult to document and very challenging to audit. We believe that due to the large number of assumptions that will be used to determine fair value and the significant judgment associated with each assumption, any fair value estimate of our standing timber will not be reliable for accounting purposes in our opinion. In our view, the reduction in reliability far outweighs any potential benefit from reporting our standing timber at fair value.

**The Marketplace Has Not Accepted Fair Value Accounting for Non-Financial Assets**

We are concerned that we will be penalized for reporting our standing timber at fair value because in our view the marketplace has not accepted fair value accounting for non-financial assets, especially long-lived assets such as timberlands. We believe that amounts reported at fair value must be highly reliable (such as financial assets traded in active markets) before fair value accounting is preferred over historical cost. Our investors understand amounts reported under historical cost because they are based on verifiable and auditable market transactions for specific assets; and therefore, we believe our investors have confidence in our reporting of operating margins for our timber business.

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 5**

It is our understanding that over 100 countries around the world have already adopted IFRS, and many more countries are in the process of adopting it. Additionally, based on our limited research it appears that companies owning standing timber and reporting under IFRS are reporting their standing timber at fair value in accordance with IAS 41. However, we do not believe that this implies that international investors have gained an understanding or have accepted the reporting of fair value for standing timber. Instead, we believe investors have not had to focus on this issue because standing timber is not a material asset for the companies reporting under IFRS. Summarized below is the reported fair value for standing timber and recent enterprise value for some of the largest wood products companies currently reporting under IFRS (amounts in millions):

| COMPANY | COUNTRY | FAIR VALUE OF TIMBER | ENTERPRISE VALUE | PERCENTAGE OF VALUE |
|---|---|---|---|---|
| UPM Kymmene | Finland | $1,460 | $13,498 | 11% |
| Stora Enso | Finland | $118 | $11,276 | 1% |
| Sappi Limited | South Africa | $635 | $4,192 | 15% |
| Mondi LTD | South Africa | $329 | $4,620 | 7% |
| M-Real | Finland | $65 | $3,070 | 2% |

The wood products companies listed immediately above are primarily integrated wood products manufacturers. The fair value of standing timber does not represent their primary asset, nor is it a significant percentage of the company's enterprise value. Plum Creek is primarily in the business of growing and harvesting timber, and we are the largest private owner of timberlands in the United States. Based on high-level estimates, we believe the fair value of our standing timber (significantly greater than $5 billion) to be far in excess of any of the companies listed above, and well over 50% of our enterprise value. We believe no company to date has been significantly impacted by the fair value reporting of standing timber. However, because standing timber is our largest single asset, we expect that investors will conclude that our reported earnings under IFRS are less transparent and are more subject to management's estimate and, therefore, are less reliable. We believe these changes in perceptions will negatively impact our stock performance.

Furthermore, we believe international investors have not focused on the challenges associated with estimating the fair value of standing timber because most of the world's timber is not owned by publicly traded companies. In fact, approximately 84% of the world's timberlands are owned by governments. For example, in Canada 92% of the timberlands are owned by the Canadian government. However, in contrast, only 43% of the timberlands in the U.S. are owned by the government (most of which are not actively managed for industrial timber production). As a result, the United States appears to be unique, whereby the implementation of IAS 41 will significantly affect companies whose principal business is the ownership and management of industrial timberlands. We believe the challenges associated with estimating the fair value of standing timber for accounting purposes will become an issue for investors seeking to evaluate U.S. companies whose principal business is the management of industrial timberlands and who are required to report their standing timber in accordance with IAS 41.

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 6**

**Reporting Standing Timber at Fair Value Does Not Improve Comparability**

It is our understanding that one of the objectives of requiring U.S. companies to adopt IFRS is to improve comparability. We do not believe this will be accomplished for owners of standing timber. As articulated above, there are extensive and numerous assumptions required in estimating the fair value of standing timber. Small changes in estimates can materially impact reported amounts, both earnings and standing timber inventory. We believe most estimates have a wide range of acceptability and are not likely to be consistent among companies. We also think that there is significant judgment in determining when estimates should be revised. We believe companies will not all revise estimates in the same reporting period, further reducing comparability of the income statement and balance sheet.

We do not believe this reduction in comparability can be corrected by additional footnote disclosure. The assumptions used in estimating fair value are proprietary and are generally not being disclosed today by companies reporting under IAS 41. We believe there will be significant competitive harm if key assumptions were required to be disclosed. Furthermore, even if additional disclosures were made regarding the assumptions used in estimating fair value, there are far too many estimates and assumptions for even sophisticated investors to assimilate. Therefore, we believe under IFRS our comparability will degenerate, which again will negatively impact our stock performance.

**The Cost to Compute the Fair Value of Standing Timber Far Outweighs Any Benefit**

Our final concern is that we believe the requirement to fair value our standing timber quarterly will be very costly due to the extensive documentation and auditing requirements in the United States. Even without the requirement to fair value our standing timber, we are already estimating that the adoption of IFRS will be more costly than our implementation of Section 404 (Management's Assessment of Internal Control) under the Sarbanes-Oxley Act, which exceeded $3 million. We believe the requirement to fair value our standing timber inventory will significantly increase our initial and ongoing compliance costs associated with IFRS.

We believe that if we are required to report the fair value of our standing timber, we will need an annual appraisal of our standing timber. Currently in the United States under auditing standards prescribed by the Public Company Accounting Oversight Board, annual appraisals are generally required for material, highly subjective and unverifiable accounts (e.g. goodwill). We believe that, under IFRS, our auditors will require an annual appraisal of our standing timber inventory since this is our single largest asset and any fair value estimate of our standing inventory will be highly subjective.

We estimate that an annual appraisal of our standing timber could be as high as $2.5 million, which is nearly twice as much as we are currently paying for the annual audit of our financial statements. Today it is not uncommon for us to pay approximately $100,000 to appraise 300,000 acres. Considering we own over 7 million acres of standing timber, annual appraisal costs could reach $2.5 million. We own timberlands in every major market in the United States; there are no national markets for standing timber, which will significantly add to the complexity and challenges of appraising our standing timber. An appraiser must consider the unique

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 7**

characteristics of each region and each timber stand, such as: (1) timber species, (2) stocking levels, (3) soil conditions, (4) weather patterns, (5) growth rates, (6) harvest restrictions, (7) logging and hauling costs, and (8) the demand and supply of timber in local markets. We believe that due to the unique nature of each timber stand, an annual appraisal will be extensive and costly.

We believe the cost of an annual appraisal is only one of many incremental costs that will be required to fair value our standing timber. We would expect our audit fees to increase due to their requirement to audit management's fair value estimate of our standing timber. We believe the audit testing will be extensive due to the subjective nature of management's fair value estimate. We would also expect additional costs associated with documenting and maintaining our standing timber inventory, internal controls over all of management's fair value estimates and assumptions, management's involvement with the annual appraisal process, and management's quarterly review and assessment of fair value. We believe the total combined internal and external costs required to comply with the fair value requirement of IFRS are excessive and very costly. Furthermore, since as stated above, we do not believe our stockholders will benefit from reporting standing timber at fair value; therefore, these significant additional costs outweigh any benefits from Plum Creek reporting under IFRS.

**Fair Value Estimates of Investment Property Are Not Reliable**

We estimate that included in our 7.4 million acres of timberlands at December 31, 2008 are approximately 1.5 million acres of higher value timberlands that are expected to be sold and or developed over the next 15 years for recreational, conservation or residential purposes. Annually, we update our estimate of higher value timberlands. Higher value timberlands sell for a significant premium over core timberlands and are currently estimated to have a total value of between $4 billion and $5 billion using high-level estimates. We believe higher value timberlands will be accounted for as investment properties in accordance with IAS 40 since, in addition to timber production, these assets are held more predominately for their investment value and for capital appreciation.

Similar to standing timber, we believe estimating the fair value of higher value timberlands requires numerous and extensive assumptions. Substantially all of our higher value timberlands are rural timberlands in which there are no national markets. We have identified thousands of parcels which we believe can be sold as higher value timberlands, each with unique characteristics. Some of the unique characteristics which distinguish higher value timberlands from core timberlands are: (1) properties located on or near lakes, rivers and streams, (2) properties with recreational opportunities such as fishing and hunting, (3) properties with territorial views, (4) properties near expanding populations centers, and (5) properties which are suitable for conservation or development.

In our opinion, in most of our operating regions fair values for higher value timberlands can rarely be based on comparable sales due to the limited number of transactions and the unique characteristics of each parcel. Therefore, fair values are estimated using the discounted cash flow model. Some of the assumptions used in estimated fair value are: (1) current prices for properties with similar characteristics such as water features, (2) land appreciation rates, (3)

Exhibit 2 (continued)

**Plum Creek letter to the SEC, p. 8**

estimated timing of sales (4) property listings by other parties, (5) market absorption rates, (6) demographic changes, (7) expansion of population centers, and (8) discount rates. As a result of the extensive number of highly subjective assumptions, we believe a fair value estimate of our higher value timberlands will not be reliable for accounting purposes within an acceptable range. Furthermore, due to our extensive ownership of timberlands, we believe that small changes in estimates could have significant changes in our reported fair value. We also believe that due to the subjective nature of any fair value estimate, we would incur significant costs is estimating the fair values, documenting the fair values, designing and testing controls associated with the fair value estimates, and required audits in connection with these estimates.

**Summary**

In summary, we believe the implementation of IFRS for Plum Creek will be costly, significantly lower the quality of our financial reporting and we believe that the reported fair value of standing timber at the end of each quarter in accordance with IAS 41 may bear no close relationship to the ultimate selling price for our trees. We also believe that it remains undemonstrated whether reporting the fair value of standing timber is more readily understood than historical cost and equally questionable whether the fair value of standing timber is more reliable, relevant or improves comparability. Additionally, due the subjective nature of numerous assumptions, we do not believe that a fair value estimate of our higher value timberlands is reliable for accounting purposes within an acceptable range.

Therefore, considering that standing timber is our largest single asset and that we own thousands of parcels of higher value timberlands and whereby both are reported at fair value under IFRS, we believe based on all the reasons expressed above that with respect to our financial reporting, it would be better for our stockholders if public companies in the United States were not required to adopt IFRS. Alternatively, if the Commission does require public companies to adopt IFRS, we request that either the adoption of IFRS be delayed until IAS 41 and IAS 40 can be amended to exclude standing timber and higher value timberlands from the requirement to report them at fair value, or the Commission allows owners of standing timber and higher value timberlands to continue to account for such using historical cost in accordance with the existing principles under U.S. Generally Accepted Accounting Principles.

Sincerely,

David W. Lambert

David W. Lambert
Senior Vice President and Chief Financial Officer

Exhibit 3

**Report from Brookfield Timberlands Management LP, p. 2**

Brookfield

## International Financial Reporting Standards: A North American Perspective

Companies that own and operate timberlands in many regions of the world, including Europe, Scandinavia, and South Africa, have already adopted International Financial Reporting Standards ("IFRS"). The major timber producing countries in South America either have or are in the process of adopting IFRS and Canada is adopting IFRS in 2011, but has permitted early adoption. Brookfield has taken the option to adopt early as we believe the advantages of presenting the fair values of our assets outweigh the challenges created by net income fluctuations due to changes in fair value.

With pressure building for the United States to adopt IFRS we've taken the opportunity in this issue, to discuss some of the advantages and disadvantages of adoption in a private timberlands context and to share the methodology we, in consultation with our timberlands appraisers, developed for determining the value of the key components of a timberland asset.

### Disadvantages of IFRS

#### Standard inadequate for timber

IAS 41 – *Agriculture* is the Standard applied to Timber. It is often suggested that this Standard was developed for annual farm crops and, as a result, it does not adequately consider the long growing cycles of timber. Valuing the crop from an apple orchard at the end of an accounting period, for example, is much simpler than determining the value of a standing timber inventory with its mix of ages, quality, species, harvesting costs and market opportunities. The subjectivity involved in establishing the timber value will cause significant heartburn for timber company managers and their auditors.

#### Income statement even more difficult to interpret

Understanding the income statement will become even more difficult than it already is. Charges for timber depletion (already an arguably meaningless number) will be replaced by charges for the fair value of timber harvested. This charge will effectively be equal to gross margin, so net income will actually result from recognizing the value of timber growth and from any changes in fair value of the standing timber inventory rather than from the harvest and sale of timber. If that weren't confusing enough, the fair value adjustments introduce the possibility of significant swings in periodic net income. This will increase the importance of clearly reporting non-GAAP measures such as EBITDA and funds from operations. Management must ensure that users of the financial statements are able to draw a clear linkage between harvest levels and the corresponding cash flow.

#### Valuation process adds real cash costs

If lending agreements or agreements with investors do not already require it, appraisals will need to be conducted with adequate frequency to ensure values are reasonable and defensible to external auditors. We view the minimum frequency to be every three years, but in periods of volatility more frequent appraisals are likely to be necessary to meet investor and auditor expectations. With appraisals typically costing $0.10 - $0.20 per acre with additional costs incurred in gaining auditor sign off on the key assumptions underlying the appraisal and on any management assumptions used to establish values in periods between appraisals, this appraisal process can result in significant cash costs.

### Advantages of IFRS

#### Book values become more relevant

While it's undeniable that the Standard will cause the income statement to become even less meaningful than it is today, savvy timberland investors know that the value of their investment is determined by its cash generation potential not by any measure of net income and that cash generation is not affected by changes in accounting methodology. The benefit of IFRS is that the book values on the balance sheet should provide a meaningful and consistent measure of the present value of future timber cash flows.

#### HBU component of timberland more transparent

IFRS requires separate presentation of land held for investment purposes (i.e. HBU Properties). Assuming management adopts the fair value model, readers of financial statements will be able to determine the relative portion of the company's total asset value that consists of HBU properties. It should be noted, however, that to be classified as an Investment Property, a property must meet several tests:

- Specific boundaries of the area being considered for HBU must have been determined;
- The land must no longer be in agricultural use (i.e. no longer being managed for the growth of timber); and
- The property must not be listed for sale.

The specificity of these guidelines should reduce the opportunity for overstatement of near-term HBU opportunities.

#### Financials more globally comparable

Timberland investing happens at a global level and since most of the world has already adopted IFRS, conversion in North America will result in more comparable financial reporting.

Source: First Quarter 2009 Global Timberlands Research Report, Brookfield Timberlands Management LP. Note that page 1 was the cover page of the report.

Exhibit 3 (continued)

**Report from Brookfield Timberlands Management LP, p. 3**

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## Components of Timberland Value

IFRS requires the assets of timberlands operations as presented on the balance sheet to be separated between timber and bare land and improvements (roads and bridges) as each falls under a different Standard. As Brookfield took the option to re-value all of the assets upon adoption of IFRS, verifiable values for each component were required.

After discussions with several well known North American timberland appraisal firms, we learned that no agreed upon methodologies existed for valuing the bare land, roads and bridges components of a timberland asset. As a result, we have worked with these firms to establish them. Our goal was to develop a methodology that meets the following criteria:

- Meets both International Valuation Standards and International Financial Reporting Standards;
- Is consistent with appraisal theory;
- Is straightforward to apply in practice;
- Is repeatable, and
- Is based on readily available data.

### Soil expectation value is the best fit for bare land valuation

The most common technique for estimating the market value of bare land is the use of the comparable sales approach in which the market value is derived from actual transactions of bare or recently harvested land. While it is often possible to find small properties of this type, it is not common to find large acreage sales of bare land, and so use of bare land values derived from small property sales to estimate bare land values for large properties is a typical, but not a very satisfactory practice.

Our preferred approach to estimating land value in forestry use is Soil Expectation Value ("SEV"), sometimes referred to as Land Expectation Value or Soil Rent. SEV measures the present value of bare timberland if used in perpetual timber production, (i.e. one rotation after another following a constant rotation length and the same silvicultural treatments.) SEV is an income-based approach as it measures the present value of the net returns from a continuing series of rotations. While use of the SEV procedure has sometimes been criticized as providing an investment value rather than a market value, it was concluded that SEV offered the best fit given the income approach is the basis for most timber appraisals.

### Avoided cash outlay approach best for roads and bridges

The value of a road or bridge can be characterized as the avoided future cost of building the road or bridge to access future timber. The presence of an existing road system reduces future costs because roads and bridges are relatively long-lived assets. Within the context of IFRS, the only roads that add contributory value to the property are those that are permanent. These include the main haul roads and secondary feeder roads that are used to access timber from general areas as opposed to roads that access specific harvest blocks. We call these "capital roads."

The preferred valuation procedure is again an income approach. The procedure estimates the avoided cost of future road construction, spreading the estimated current construction cost of the existing inventory of capital roads into the future as if they needed to be constructed for the first time. The value of the existing road system is realized as future harvest costs are lower than they would be if the road system was not in place.

The general approach is as follows:

- Estimate the current cost of building the entire system of capital roads and bridges;
- Make an adjustment for the current condition of roads and bridges. If the roads are all maintained in a like-new condition then no adjustment is needed, but if the current road system needs some reconstruction or replacement during the valuation period, that cost must be considered and subtracted from the projected road construction costs. Bridges have a finite lifespan, and the depreciated portion of the bridge must be recognized;
- Schedule the construction costs over a build-out period in a way that that recognizes the projected harvest schedule from the appraiser's DCF analysis; and,
- Calculate the present value of the assumed future road build-out to the present using the same discount rate applied to the cash flows from timber harvesting.

The present value of the assumed future road build-out represents the value of the road system.

### Value of standing timber inventory is the residual

With the value of the bare land and improvements established, the value of the standing timber inventory becomes the residual of the total appraised value of the property less bare land, roads and bridges.

Exhibit 3 (continued)

**Report from Brookfield Timberlands Management LP, p. 4**

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## Publicly Traded Timberland Companies in North America are Unique

While the adoption of IFRS will not have much impact on timberlands held within private funds as current Canadian and US GAAP already allow for fair value treatment if the assets qualify for investment company accounting, the impact for publicly traded companies will be more significant. North America is somewhat unique in a global context in having several large publicly traded companies in which timberlands make up the majority of assets held. This is not the case for many of the global companies that have already adopted IFRS.

**Figure 1:**

**Reported fair value for standing timber and recent enterprise value for some of the largest wood products companies currently reporting under IFRS (amounts in US$millions):**

| Company | Country | Fair Value of Timber [1] | Enterprise Value [1] | Percentage of Value |
|---|---|---|---|---|
| UPM Kymmene | Finland | $1,581 | $10,979 | 14% |
| Sappi Limted | South Africa | $631 | $5,223 | 12% |
| Mondi LTD | South Africa | $298 | $4,557 | 7% |
| Stora Enso | Finland | $186 | $10,460 | 2% |
| M-Real | Finland | $79 | $3,193 | 2% |

Source: Brookfield internal research and publicly available data.
[1] Based on latest available information and share prices at June 5, 2009

The changes in fair value in an accounting period that flow through the income statement is likely not as big of a concern for these companies as it will be for the publicly traded timber companies in the US.

With US adoption currently proposed for 2016, we expect to see this unique situation receive careful consideration.

## Adoption of IFRS an Overall Net Positive for Timberlands Investors

While we accept that the adoption of IFRS will lead to the addition of some modest cash costs and may lead to some investor confusion at the outset, we believe that the greater transparency provided by the presentation of reasonable fair value estimates outweighs these disadvantages. Further, we believe that with strong emphasis on the presentation of cash flow measures, investors will have information that is much more useful to their investment decision making processes.