FINAL DRAFT OF COMMENT LETTER ON
FASB ED PROPOSING AMENDMENTS TO SFAS 67

October 15, 2001

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
File Reference 1063-001
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed Statement of Position: *Accounting* for *Certain Costs and Activities Related to Property, Plant and Equipment* and Proposed Statement of Financial Accounting Standards: *Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant and Equipment an amendment of APB Opinions No. 20 and 28 and FASB Statements No. 51 and 67 and a rescission of FASB Statement No. 73*

Dear Tim:

The National Association of Real Estate Investment Trusts (NAREIT) has followed and directly supported the Accounting Standards Executive Committee's (AcSEC) process and deliberations with respect to its proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment.* NAREIT representatives have attended public AcSEC meetings at which this project has been discussed and provided AcSEC's Project Task Force with NAREIT's preliminary views and concerns based on the materials discussed at these meetings.

We have provided AcSEC with our comments on its June 29, 2001 Exposure Draft (AcSEC ED) of the proposed SOP. This comment letter provides the Financial Accounting Standards Board (the Board) with comments on its June 29, 2001 Exposure Draft (FASB ED) regarding amendments (the proposed amendments) to a number of long-standing accounting standards that would require changes if the AcSEC ED is adopted as exposed. Of particular importance to NARE1T members are the proposed amendments to SFAS No. 67 (SFAS 67), *Accounting for Costs and Initial Rental Operations of Real Estate Projects.*

NAREIT is the national trade association for real estate investment trusts (RE1Ts) and other publicly traded real estate companies. NAREIT members include over 200 REITs and other companies that develop, own, operate, and finance investment property,[1] as well as those firms and individuals who advise, study, and service these businesses. Providing useful and relevant financial information related to investment property, is of vital importance to the capital

[1] Investment property is also referred to as income-producing real estate, both of which are defined as real estate held for rental and/or capital appreciation.

formation and investor relations activities of companies involved in these businesses.

NAREIT has, and will continue to, actively support the development of transparent accounting and reporting standards. Our goal is to responsibly advocate accounting standards that reflect the economic reality of acquiring, developing, owning and operating investment property. In this context, the standards for accounting for the costs of these assets are fundamental to producing useful financial reports for real estate companies that acquire, develop, own and operate investment property. These standards may have a more significant impact on the financial statements of these companies than on the financial statements of most companies that simply use property, plant and equipment in the production of products or delivery of services, since property assets account for the great majority of member company assets and maintenance of these properties represents a significant annual cost.

Scope of Proposed SOP and Amendments

We understand and appreciate that there may be a need to provide clearer guidance with respect to:

?? accounting for the costs of long-term capital maintenance programs,
?? disclosure of accounting policies governing the accounting for the cost of repairs and maintenance,
?? depreciation methodology and measurement parameters, and
?? providing more useful disclosures with respect to appropriate categories of property, plant and equipment (PP&E) and depreciation.

At the same time, and in addition to specific concerns regarding the proposed SOP, we believe the scope of the proposed SOP extends far beyond the "Accounting Issues" identified in the project prospectus. Each of the issues identified in paragraphs 5 through 8 of the prospectus focus specifically on accounting for expenditures made subsequent to the initial installation, development or construction of PP&E. Beyond the scope indicated in the prospectus, the ED would create new accounting for:

?? the initial costs of installing, developing and constructing PP&E,
?? carrying costs during the initial lease-up phase of a real estate project, and
?? overhead costs relating to the initial development and construction of PP&E.

Standards with respect to each of these areas are set forth in SFAS 67.

In addition, the scope of the prospectus specifically states that the project will not cover depreciation. However, the proposed SOP would eliminate the group and composite methods of depreciation and would require, instead, a depreciation system that would require extensive and costly changes to virtually universal depreciation practices. We strongly object to the implicit elimination of the group and composite methods of depreciation, especially when the project prospectus indicated that the project would not cover depreciation.

As with the proposed SOP, we believe that the proposed amendments go far beyond the reasons for the SOP and amendments as discussed in the introduction of the FASB ED. Paragraph 2 of this ED states that, "the AICPA's Accounting Standards Executive Committee (AcSEC) and the chief accountant of the Securities and Exchange Commission (SEC) informed the Board that practice was diverse **in accounting for improvement or "repair and maintenance" type expenditures** (emphasis added) for real estate assets because of a lack of authoritative guidance covering such items."

While we may not be fully aware of the AcSEC's/FASB's due process with respect to the development of AICPA Statements of Position and FASB Statements of Financial Accounting Standards, we believe the accounting provided for in the proposed SOP should be limited to addressing the accounting issues identified in the approved project prospectus and the scope of the proposed amendments should be limited to addressing the issues identified in the introduction of the FASB ED.

SFAS 67 Consistently Applied to Initial Development and Construction Costs

We have not seen evidence that accounting practices with respect to costs of **acquiring, developing or constructing** PP&E are significantly diverse. It, therefore, is difficult for us to conclude that principles contained in SFAS 67 have provided incorrect or misleading guidance for almost 20 years. Contributing to the longevity and continued relevance of SFAS 67 was the FASB's 1982 review of these principles that were originally contained in AICPA Statements of Position. We do not understand why the AICPA/FASB would want to continue to expend resources on amending a standard that has provided clear guidance for over 20 years, since SOP 78-3 was issued, and that was reviewed and re-issued by the FASB in 1982.

Further, the principles provided in SFAS 67 covering the accounting for costs of initially developing investment property, are appropriate as evidenced by their consistency with the cost accumulation model provided for in Statement of Financial Accounting Standards No. 19 (SFAS 19), *Financial Accounting and Reporting by Oil and Gas Producing Companies* – Level A GAAP not covered by the proposed SOP. We believe that it is significantly more appropriate for the cost accumulation model for investment property to follow the model used for the production of oil and gas than the model used for the acquisition of financial assets or the development of software – the bases of the model provided for in the AcSEC ED.

In summary,

- **we are not aware of any evidence, including statements by AcSEC or the Board, that accounting issues exist with respect to the accounting for initial development and construction costs as set forth in SFAS 67 and**
- **the cost accumulation model used in SFAS 67 is consistent with the model in SFAS 19.**

Therefore, we object to the amendments to SFAS 67 that would modify the accounting for

the initial costs of developing and constructing investment property.

Inconsistency with Core International Standards

While not specifically covered by the FASB ED, we feel compelled to address the significant inconsistency between the proposed accounting for PP&E in the AcSEC ED and the accounting standards specifically covering investment property in International Accounting Standard No. 40 (IAS 40), *Investment Properly.*

The economics of owning and operating investment property are far different than the economics related to PP&E used to provide goods and services. IAS 40 recognizes the unique economic characteristics of "investment property." Characteristics that distinguish investment property from most property, plant and equipment include the following:

?? Each property is unique in terms of location, design and tenant mix.
?? Cash flows are directly associated with renting or leasing the property to unaffiliated parties.
?? Future long-term cash flows generated by the property are reasonably estimable — they are supported by contracts (leases).
?? In many cases, the cost of the property is funded by specifically related non-recourse mortgage debt that has been underwritten by third-party lenders on the basis of the quality of projected cash flows.
?? There is an active market for the exchange of investment property.
?? The value of well-maintained investment property generally increases over time.

IAS 40, a part of the core international accounting standards, requires disclosure of the fair value of investment property either in the financial statements or in accompanying notes. **To achieve this measurement and disclosure, it views an investment property as an integrated operating entity, a package of service potential – not as an amalgamation of hundreds of components.** IAS 40 also addresses the accounting for "subsequent expenditure."

In testimony at a July 31, 2001, House Energy and Commerce Subcommittee meeting, Edward Jenkins, Chair of the FASB, stated:

> We [FASB] are committed to having a close, active and constructive relationship with the IASB [International Accounting Standards Board] and other standards setters in achieving convergence of high quality financial reporting standards around the world.

To require owners/operators of investment property to dramatically move in a direction counter to the more far-reaching direction of international accounting standards seems inappropriate, unnecessary and inconsistent with the FASB's commitment to achieve international convergence of high quality accounting standards. **We believe that changing U.S. GAAP to require extensive, detailed componentization of the costs of investment property while core international standards view them as integrated operating entities, would result in the real**

estate industry's financial reporting and accounting systems being whipsawed as the U.S. moves toward convergence with international standards.

Therefore, if the final SOP requires the detailed level of componentization described in the ED, we request that investment property be excluded from this requirement. As fully explained in our comment letter to AcSEC, we would support componentization of PP&E costs to a reasonable level.

NAREIT appreciates the opportunity to participate in FASB's standard setting process. This comment letter has been developed by a Task Force of NAREIT members and has been reviewed and approved by NAREIT's Best Financial Practices Council. A list of companies represented by these participants is included in the enclosed exhibit. If you have any questions regarding this response, please contact George Yungmann at (202) 739-9432 or David Taube at (202) 739-9442.

Respectfully Submitted,

George L. Yungmann
Vice President, Financial Standards

Exhibit

NAREIT Task Force and Best Financial Practices Council– Comment Letter Contributors

AMB Property Corp.	Keystone Property Trust
AMLI Residential Properties Trust	Kilroy Realty Corp.
Arthur Andersen	Kimco Realty Corp.
Associated Estates Realty Corp.	Koger Equity Inc.
BNP Residential Properties Inc.	KPMG
BRE Properties Inc.	LaSalle Investment Management Securities
CAPREIT Inc.	Legg Mason Wood Walker Inc.
Chatham Financial Corp.	Mack-Cali Realty Corp.
Christopher Weil & Co.	Manufactured Home Communities
CNL Fund Advisors	MeriStar Hospitality Corp.
Corporate Office Properties	Mills Corp.
Cousins Properties Inc.	Pennsylvania REIT
Crown American Realty Trust	PricewaterhouseCoopers
Deloitte & Touche	Reckson Associates Realty Corp.
Ernst & Young	Salomon Smith Barney
Equity One Inc.	Security Capital Group Inc.
Equity Residential Properties Trust	Simon Property Group
Fidelity Management & Research	SL Green Realty Inc.
Forest City Enterprises	Summit Properties Inc.
General Growth Properties Inc.	Taubman Centers Inc.
Goldman Sachs	The Rouse Company
Green Street Advisors	Vornado Realty Trust
Host Marriott Corp.	Washington REIT
HVP Capital Management Inc.	Watson Land Company
Intellectual Capital Markets	