

bulletin

National Association of Real Estate Investment Trusts®

NAREIT Affirms Commitment to GAAP Net Income as Primary Industry Earnings Measure

**Provides Guidance on
Supplemental Measure:
Like Bottom-Line GAAP Net
Income, FAS 144 Requires No
Change to FFO**

Summary

The Financial Accounting Standards Board (FASB), the arbiter of generally accepted accounting principles (GAAP), recently finalized Financial Accounting Standard No. 144 (FAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, and provided guidance on implementation of this standard to real estate sales.

After considering the impact of the new standard on income statements prepared under generally accepted accounting principles (GAAP) and on the industry's supplemental operating performance reporting, NAREIT's Board of Governors on April 4, 2002, unanimously adopted several recommendations of the Association's Best Financial Practices Council. Chief among

them is affirmation of NAREIT's commitment to GAAP net income as the primary industry earnings measure.

The Board also adopted a recommendation that Funds From Operations (FFO) from income-producing property held for sale, sold or otherwise transferred and now reported in "results of discontinued operations" should be included in consolidated FFO, the industry's supplemental earnings measure.

The resulting clarification of NAREIT's White Paper on Funds From Operations was needed to ensure that a change in a GAAP classification made by FAS 144 did not create an inappropriate and unintended change in reported FFO. The clarification results in no change to FFO — mirroring the impact of FAS 144 on bottom-line GAAP net income.

Action

NAREIT's Board of Governors adopted the following findings and recommendations of the Best Financial Practices Council:

- ◆ NAREIT recognizes and emphasizes that net income, as defined by GAAP, is the primary earnings measure for real estate companies.
- ◆ NAREIT welcomes the efforts of analysts and others to increasingly rely upon and utilize net income, as defined by GAAP, in analysis of the real estate industry as well as individual companies.

- ◆ NAREIT will primarily utilize in the future GAAP net income to the extent practicable, supplemented by FFO, in its analysis of and communication about the publicly traded real estate industry.
- ◆ NAREIT believes that FFO remains a useful supplemental earnings measure for a variety of reasons, including the treatment of depreciation and property sales under GAAP.
- ◆ NAREIT believes that, consistent with the intended purpose of FFO and past practice, relevant financial items from income-producing properties whether currently in use, held for sale, sold or otherwise transferred should be presented as part of FFO for current periods as well as prior periods presented.
- ◆ NAREIT believes that, as FAS 144 does not change bottom-line net income, it should not change “bottom-line FFO.”
- ◆ NAREIT, as a result, has clarified its White Paper on FFO to make it clear that relevant financial items from income-producing property that is held for sale, sold, or otherwise transferred should continue to be included in the computation of FFO.
- ◆ NAREIT notes that net income, as defined by GAAP, in fact includes the specific financial items that NAREIT has determined should continue to be included in the computation of FFO; as result, if the NAREIT White Paper were not clarified, important items that remain part of GAAP net income would be excluded from the computation of FFO.

- ◆ NAREIT recommends that full disclosure be made of amounts reported in “results of discontinued operations.” These disclosures should identify FFO, gains/losses and other items included in results of discontinued operations.
- ◆ Finally, NAREIT believes that, without this clarification, reported FFO would have reduced utility, less consistency, and a confused meaning.

This clarification of FFO is effective January 1, 2002 and should be applied to all periods presented in financial statements or tables.

NAREIT’s White Paper on Funds From Operations has been updated to reflect this clarification of the supplemental benchmark and to provide guidance in implementing this clarification. NAREIT members are urged to follow the principles and guidance described in the White Paper, which can be found in the “Accounting Issues” section of NAREIT’s web site, www.nareit.com.

In reaching its recommendations, the Best Financial Practices Council and Board of Governors considered comments received from member companies, as well as industry investors, analysts and other participants.

for further information,
please contact:

George Yungmann
gyungmann@nareit.com
202-739-9432

David Taube
dtaube@nareit.com
202-739-9442