NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

December 27, 2001

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

Re: Application of SFAS 144 to Discontinued Operations

Dear Mr. Lucas:

The National Association of Real Estate Investment Trusts (NAREIT) would like to bring to your attention its concerns regarding the changes Statement of Financial Accounting Standards No. 144 (SFAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*, could require for the reporting of discontinued operations. We understand that certain parties have interpreted SFAS 144 to require the extension of discontinued operations to **all** "components" of an entity, rather than **only** to "significant components." For real estate companies that frequently dispose of "insignificant components," this reporting could create considerable confusion among financial statement users. NAREIT requests that the Board clarify its intent regarding the reporting for the disposal of investment property judged to be an insignificant component of an entity.

NAREIT is the national trade association for real estate investment trusts (REITs) and other publicly traded real estate companies. Members include REITs and other businesses that develop, own, operate, and finance income-producing real estate, as well as those firms and individuals who advise, study, and service these businesses. The business of developing, owning and operating income-producing property regularly involves the disposition of individual or groups of properties from a company's portfolio. In this context, the accounting standards for property dispositions are important to producing useful and relevant financial reports for publicly traded real estate companies.

When the Board issued its July 2000 Exposure Draft of the proposed standard, the reporting for discontinued operations was applicable or extended **only** to a "significant component of an entity." Further, paragraph 42 of the proposal

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specifically stated: "In assessing whether a component of an entity is significant, an entity shall consider all relevant facts and circumstances, quantitative and qualitative." NAREIT's comment letter submitted in response to the proposal did not address this issue because the use of "significant" with regard to components of a business would have allowed for judgment in determining whether a disposition would be significant and, therefore, be reported as a discontinued operation. Based on the foregoing, many dispositions of individual or groups of properties would not be judged to be significant.

As indicated in SFAS 144's basis for conclusions (paragraph B103), "the Board chose not to define the term *significant* to allow for judgement in determining whether, based on facts and circumstances unique to a particular entity, a disposal transaction should be reported in discontinued operations." However, the language in paragraph 42 of the Exposure Draft that would allow for this judgement was eliminated from the final standard. Some believe that a literal reading of SFAS 144 does not provide the latitude contemplated in paragraph B103.

Under SFAS 144 provisions for reporting discontinued operations, a component "comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity." Consistent with example 15 of Appendix A, some have interpreted this scenario to mean that if a real estate company owning and operating multiple properties within a market area disposes of one property in that market, the disposal would not have to be reported as discontinued operations because the operations have not been eliminated. In many cases, the operations of one property cannot be clearly distinguished because multiple properties located within a market area typically share corporate resources such as property management, leasing, security, and maintenance personnel.

Further, in many cases the cash flows of the disposed property are replaced through exchange, purchase, or improvement of another property within the same or different market. In any of these situations, the capital is reinvested to replicate and/or enhance the cash flows associated with the disposed property, rather than distributed to shareholders.

If the Board intended that the disposal of an individual property or an insignificant group of properties be reported as discontinued operations, we believe this would create significant confusion among financial statement users. It is not unusual for real estate companies to frequently dispose of properties. In a recently completed study, we reviewed the frequency of reported gains/losses from property dispositions by 40 large real estate companies during 1998, 1999 and 2000. Of the 120 annual periods (40 companies, 3 years) reviewed, property dispositions were reported in 103 (86%) of the annual periods. Further, 28 (70%) of the companies reported property dispositions in each of the three years reviewed. Treating **all** of these dispositions as discontinued operations and, therefore, constantly restating previously reported operating results, would cause a great deal of confusion.

Further, we believe that reporting discontinued operations suggests a shift in a company's business plan and, therefore, should not be used for insignificant dispositions. For example, it would be inappropriate for a real estate company that owns and operates hundreds of office buildings to report the disposition of one building or any number of buildings having an insignificant effect on a company's cash flows as discontinued operations.

We respectfully request that the Board clarify its intention "to allow for judgement in determining whether, based on facts and circumstances unique to a particular entity, a disposal transaction should be reported in discontinued operations." We do not believe that the examples in SFAS 144 provide adequate clarifying guidance.

NAREIT appreciates the opportunity to continue to participate in Board's standard setting process. This comment letter has been reviewed and approved by NAREIT's Best Financial Practices Council. 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