

Update



NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

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FASB**Publishes Tentative Decisions on Business Combinations**

On July 27, 2004, the Financial Accounting Standards Board (FASB) published a summary of

tentative decisions with respect to Business Combinations. These tentative decisions are the precursor to an Exposure Draft (ED) that is expected to be released later this year, as a revised FAS 141(R). These tentative decisions may change prior to issuance of the ED. Some of the major changes to the current standard include:

- Transaction costs of the acquirer incurred in connection with the acquisition of the business acquired would not be included in the measurement of the fair value of the business acquired, as is the current practice. Those costs, which are not part of the consideration exchanged for the business acquired, would be accounted for separately (generally as an expense when incurred).
- The fair value of equity securities of the acquirer issued as consideration would be measured at the acquisition date rather than at the agreement date.
- Assets acquired and liabilities assumed for contingencies of the acquired business that meet the definition of an asset or a liability at the acquisition date but previously were not required to be recognized under the criteria in FASB Statement No. 5, *Accounting for Contingencies*, would be required to be recognized and measured at their fair value.

Click [HERE](#) to access the full draft of the FASB's Tentative Decisions.

Publishes Tentative Decisions on Noncontrolling (Minority) Interests

During 2003, the FASB had issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (SFAS 150). SFAS 150, as interpreted by many accounting practitioners, would have had a detrimental effect on the financial reporting of public real estate companies because it would have treated certain minority interests as liabilities to be reported at settlement (fair) value at each balance sheet date. This would have created a distortion in the financial statements by reporting the minority interest liability at fair value, but not reporting the underlying asset at fair value.

NAREIT lobbied to reverse the implications of SFAS 150 by meeting with the deputy chief accountant of the SEC and discussing NAREIT's concerns with the FASB and its staff. Based on our efforts, the FASB reconsidered its position and recently published a summary of the tentative decisions with respect to the accounting for Noncontrolling (Minority) Interests. These tentative decisions are also the precursor to an Exposure Draft that is expected to be released later this year and may change prior to its issuance. From our reading of these decisions:

- The acquiring entity in a business combination would be required to account for the business acquired at its fair value at the acquisition date.
- The equity interests of noncontrolling shareholders, partners, or other equity holders in subsidiaries would be accounted for and presented in equity, separately from the parent shareholders' equity, rather than as liabilities or as "mezzanine" items between liabilities and equity.
- Changes in ownership interests in the subsidiary after control is obtained that do

not result in a loss of control of the subsidiary would be accounted for as capital transactions. That means that the difference between the amount by which the noncontrolling interest is adjusted and the consideration paid or received, if any, would be recognized directly in equity (additional paid-in capital). No gain or loss would be recognized in consolidated net income. Thus, the acquisition of some or all of the noncontrolling interests in a subsidiary would not be accounted for by the purchase method as in current practice. That is because at the time the parent obtains control of the subsidiary, the assets (including goodwill) and liabilities of the subsidiary would be recorded at their fair values in accordance with a revised FAS 141 (R) rather than in part at fair value and in part at carryover cost.

- Entities with one or more partially owned subsidiaries would be required to provide in the notes to the consolidated financial statements a separate schedule that shows the effects of transactions with noncontrolling interests on the equity attributable to the controlling shareholders.
- Losses attributable to the noncontrolling interest in excess of the noncontrolling interest in the equity capital of the subsidiary would be attributed to the noncontrolling interest rather than to the controlling interest.
- On the date control of a subsidiary is lost, any retained noncontrolling investment in a former subsidiary would be remeasured to its fair value and a gain or loss, if any, would be recognized in consolidated income.

Click [HERE](#) to access the full draft of the FASB's Tentative Decisions.

At its September 27 meeting, NAREIT's Best



Financial Practices Council agreed that NAREIT should establish a task force of NAREIT members to review the tentative decisions with respect to both Business Combinations and Noncontrolling Interests and comment on them at this stage in the FASB process. If you would like to serve on this task force, please contact [George Yungmann](#).

SEC

Provides Additional Guidance Regarding Shareholder Proposals

On September 15, 2004, the staff of the SEC issued Staff Legal Bulletin No. 14B (“SLB 14B”), providing guidance on certain issues that commonly arise in processing shareholder proposals under Rule 14a-8 of the Securities Exchange Act of 1934. SLB 14B clarifies and updates some of the guidance contained in Staff Legal Bulletin No. 14, published in July 2001, and provides additional guidance regarding certain substantive and procedural aspects of the shareholder proposal process. Specifically, this legal bulletin:

- clarifies the manner in which the staff will apply Rule 14a-8(i)(3) when assessing arguments that proposals or supporting statements are false and misleading in an attempt to limit the use of certain arguments by companies;
- reiterates that companies should be specific in notices of defects to shareholder proponents and provides further guidance on the proof of beneficial ownership companies should request from shareholder proponents to satisfy the Rule 14a-8(b) minimum ownership requirements;
- discusses the potential consequences of a company’s failure to submit a no-action request more than 80 days before the filing

- date of the company’s definitive proxy statement, as required by Rule 14a-8(j);
- provides guidance on how the staff analyzes an opinion of counsel when a company asserts that a proposal is excludable based on matters of state, federal or foreign law; and
- addresses the public availability of Rule 14a-8 no-action requests and discusses procedures for the staff’s release of response letters.

Click [HERE](#) to access SLB 14B.

NAREIT

Comments on FASB’s Exposure Draft on Fair Value Measurements

As mentioned in the July 2004 *Financial Standards Update*, in response to requests from constituents to improve the current guidance for measuring fair value, on June 23, 2004, FASB published an Exposure Draft, *Fair Value Measurements* (ED). The ED does not require the use of fair value for investment property, but provides guidance on how to measure fair value when required by existing authoritative pronouncements. It replaces any current guidance for measuring fair value in existing standards, such as those that govern the accounting for derivatives and financial instruments. If eventually the FASB concludes that investment property should be reported at fair value, it is probable that this ED would be used as the guide for measuring those values.

The ED defines fair value as the “price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties” and seeks to establish a hierarchy for measuring fair value that would apply broadly to financial and nonfinancial assets

and liabilities. The fair value hierarchy groups into three broad levels the inputs that should be used to estimate fair value. The hierarchy gives the highest priority to market inputs that reflect quoted prices in active markets for identical assets and liabilities, the next priority to quoted prices for similar assets or liabilities and the lowest priority to internal estimates and assumptions. Fair value could be measured using the market approach, the income approach or the cost approach. Click [HERE](#) to access the ED.

NAREIT's comment letter, dated September 7, 2004, asked the FASB to clarify whether a company or an appraiser would have to assume the highest and best use of a property when estimating its fair value, and also requested that the final standard provide examples of valuing non-financial assets and liabilities. George Yungmann participated on an AICPA/AcSEC task force that developed AcSEC's comments on the ED and recently participated in a FASB roundtable discussion of this ED. Click [HERE](#) to access NAREIT's comment letter.

Comments on SEC's Proposal on Postponement of Accelerated Filing Deadlines

On August 24, 2004, the SEC proposed to postpone for one year the completion of the final phase-in of the accelerated filing deadlines. The SEC contemplates that this would allow additional time and opportunity for accelerated filers and their auditors to focus their efforts on complying with the new requirements regarding internal control over financial reporting mandated by Section 404 of the Sarbanes-Oxley Act of 2002.

The accelerated filing deadlines would require most NAREIT member companies to file their 2004 annual reports within 60 days of year-end

and the subsequent quarterly reports within 35 days of the quarter end. Under the proposal, the deadline for most member companies to file their 2004 annual reports would remain at 75 days after year-end and subsequent quarterly reports at 40 days after quarter end. Click [HERE](#) to access the SEC proposal.

NAREIT's comment letter agreed with the SEC and strongly recommended that they adopt the proposals in the above rule so that our member companies can continue to focus on compliance with Section 404 over the next few months. We acknowledged that the requirements mandated by Section 404 are instrumental in improving the accuracy and reliability of financial reporting and that the proposed postponement of the accelerated filing deadlines would support our members as they focus on implementing these requirements carefully, diligently and thoroughly. Click [HERE](#) to access NAREIT's comment letter.

2004 Internal Audit Forum

The second annual Internal Audit Forum was hosted by Duke Realty Corporation in Indianapolis on August 24, 2004 and was attended by nearly 30 Directors of Internal Audit (IA) from various member REITs (an increase of 25 percent from last year). The IA Directors discussed a variety of topics, including the roles, responsibilities and reporting policies of their respective IA functions; compliance with the Sarbanes-Oxley Act of 2002, especially Section 404 documentation and testing; conducting risk assessments; best practices for establishing an IA function and relationships with external auditors. The group also discussed the program and arrangements for the 2005 Internal Audit Forum.

2004 SFO/IRO Workshop

NAREIT's 2004 SFO/IRO Workshop was held on September 27 and 28 at the New York Hilton.

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The Workshop was very successful and was attended by over 140 financial and investor relation professionals representing over 70 corporate members. The program included three general sessions and eight concurrent sessions providing a broad range of learning experiences for financial officers and investor relations officers. Sessions covered recently issued and proposed accounting standards, the new corporate governance and financial reporting environment, the current capital markets and best practices with respect to investor relations.

2005 Law & Accounting Conference

NAREIT's Law & Accounting Conference will be held from April 6-8, 2005 in Washington D.C. at the J.W. Marriott hotel. We encourage you to provide us with any topical programming ideas by mid-November 2004.

Seeks Input from Investors and Advisors

In an effort to enhance the quality and effectiveness of industry financial reporting disclosures, NAREIT is currently soliciting input from the investor and analyst community for its thoughts and guidance of issues that may impact our industry, its securities, and its investors.



OTHER

Goodwin Procter Issues REIT Alert on 8K Disclosures

NAREIT has received several questions regarding the new rules related to filing of Form 8Ks and any best practices associated with the above. Several members have asked whether the sale of an individual property is considered in the ordinary course of business or does it need to be disclosed by filing a Form 8K. Also, some members have asked when does a material contract that can be cancelled by either party need to be disclosed? Should it be disclosed at the date of the signing of the contract or should it be disclosed once the cancellation period has expired?

Click [HERE](#) to access a REIT Alert from NAREIT board associate member, Goodwin Procter, that attempts to clarify these issues.

NAREIT

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