NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

July 19, 2002

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
Mail Stop 6-9
450 Fifth Street, NW
Washington, DC 20549-6009

Re: File No. S7-16-02

Dear Mr. Katz:

The National Association of Real Estate Investment Trusts (NAREIT) is pleased to have the opportunity to respond to the Securities and Exchange Commission (Commission) on various proposals contained in Release Nos. 33-8098 and 34-45907. 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.

Executive Summary

NAREIT supports the Commission's efforts to improve the transparency of financial disclosures in order to enhance investors' understanding about the application of critical accounting policies. This letter addresses certain issues regarding the proposed rules and suggests changes that we believe would enhance the effectiveness of the required disclosures.

A summary of our comments follows:

- Although NAREIT strongly supports full transparency with respect to principles, policies and assumptions used by a company in its financial reporting, we believe that requiring quantitative disclosure based on alternative principles and policies not adopted by companies because they believed them to be inappropriate or inadequate would create a great deal of confusion among financial statement users.

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- In defining "critical accounting estimates," the proposed rules rely on terminology that may result in wider reporting diversity than would be the case if more familiar concepts were used. NAREIT suggests that the rules rely on the hierarchy of probability used in the application of SFAS No. 5, *Accounting for Contingencies*, rather than terms used in the proposed rules (i.e., "highly uncertain" and "reasonably likely to occur").

- The additional time to analyze alternatives with respect to critical estimates and prepare disclosures for the MD&A, and then discuss this information with the audit committee, would make it more difficult to meet the Commission's proposed accelerated filing deadlines. Given the tension between enhanced disclosure that results from discussions with audit committees, and accelerated filing deadlines, we would strongly recommend that filing deadlines not be accelerated at this time.

- NAREIT does not believe the Commission should require that the critical accounting estimates disclosure in MD&A undergo an auditor "examination" comparable to that enumerated in Attestation Standard No. 701 (AT 701). We believe that audits conducted in accordance with Statement on Auditing Standards No. 8 (SAS 8), *Other Information in Documents Containing Audited Financial Statements*, along with other disclosures required by the proposed rules and more effective Audit Committee oversight with respect to critical accounting estimates, would result in a high degree of assurance that the proposed MD&A disclosures are appropriate and accurate. If the Commission continues to believe that additional assurance is required, NAREIT believes that the final rules should explicitly require that an auditor complete a "review," not an "examination," of the proposed MD&A disclosures in accordance with AT 701.

- NAREIT agrees that the rule should require a quarterly update of the MD&A information related to critical accounting estimates discussed in the company's latest filed annual or quarterly report when material developments with respect to the estimates occur.

- Although NAREIT agrees that disclosures about the initial adoption of accounting policies would provide useful information to investors and other users of financial reports, we do not believe that companies should be required to disclose the estimated effects of alternative accounting policies that were not adopted. Consistent with our comments with respect to "scope of proposal," we believe that requiring quantitative disclosure based on alternative principles and policies would create a great deal of confusion for even professional financial statement users.

- NAREIT believes that a new, explicit safe harbor should be created for disclosure of critical accounting estimates and the accompanying discussion, as well as for accounting estimates that an issuer determines not to disclose because the issuer concludes that the estimate does not meet the definition of a "critical accounting estimate." Although the proposed rules state that the existing safe harbors for forward-looking statements can be relied upon, NAREIT believes that these do not directly or fairly address the new disclosure requirements. If legislation is required to establish appropriate safe harbors, the proposed rules should not be adopted until such legislation becomes effective.

- NAREIT disagrees with the Commission's assertion that damage resulting from the disclosure of proprietary or sensitive information from the proposed rules would be mitigated by the fact that all competitors would be subject to the same requirements. Our detailed comments provide specific examples that support this view.

Scope of Proposal

NAREIT supports the Commission's attempt to provide users of financial statements with information about critical accounting polices (CAPs). At the same time, we believe that users are best served by in-depth information about a company's business transactions and about the application and impact of accounting policies the company actually employs. We believe that disclosures regarding the effects of applying or adopting alternative policies or principles would create confusion for financial statement users – even for financial analysts who have an understanding of generally accepted accounting principles (GAAP).

In addition, disclosures of the effects of using or adopting principles or policies other than those actually used by the company would create challenges similar to those referred to by Commission Chief Accountant Robert K. Herdman in an April 18, 2002, speech about international accounting standards (IAS). With regard to the requirement that foreign issuers maintain two sets of financial statements (one in accordance with IAS and the other with US GAAP) Herdman said that issuers and others were concerned that "Companies would report the results of their operations under the two sets of standards and, in some instances, those results would be markedly different. As a result of reporting under two different standards, the company would have the challenge of explaining that both sets of financial statements were "correct", even though the amounts reported showed different results, sometimes significant in amount." Similarly, NAREIT believes that dual reporting, based on actual accounting policies and principles and alternative policies and principles *not* adopted by companies, would be difficult for users to understand, even with carefully tailored cautionary statements concerning the limitations and uses of the alternative disclosure.

Consistent with this view, the proposed rules should not require a company when it discloses a CAP to discuss the impact of its choice among accounting methods used in the company's industry. NAREIT believes that the company may not have a clear understanding of the alternative accounting methods used throughout its industry and the circumstances that led other companies to the selection of those methods. Further, in many cases, the determination of what is the company's "industry" may be both vague and subjective. Therefore, users could be presented with significant variations in disclosures by companies operating in the same "industry," and may also be led to inappropriate conclusions regarding the company's selection of accounting methods.

The following three examples illustrate the challenges of disclosing the effects of alternative accounting principles or policies.

Example I – Profit on Sale of Real Estate
The accounting principles for recognizing profits on sales of real estate are complex and must be applied after considering the specific facts and circumstances of each transaction. One company's sale of an office building may be reported on the "full accrual" method, while another company's sale of an office building may be reported using the "partial accrual" or "deferred" method, all within GAAP. Although each of these methods may be most appropriate under the unique terms of each sale, they result in very different profit measurements. It seems virtually impossible to communicate a clear understanding of the reasons for these differences – especially to unsophisticated users of the financial statements. The possibility exists for these users to conclude that the higher profit recognized was simply a result of arbitrarily applying a more aggressive accounting method – not a result of applying the most appropriate accounting method in the circumstances. In this case, disclosure of the terms of the transaction and the accounting principle applied should provide financial statement users with the most useful information about the impact of the transaction on the company's profitability.

Example II – Profit on Sale of Land
The accounting principles for recognizing profit on sales of land are complex and must be applied after considering the specific facts and circumstances of each transaction. One company may calculate the cost of land sold based on an average cost per acre while another company's land costs might be allocated to sales based on relative fair value. While each of these methods may be most appropriate under each company's circumstances, they may result in very different profit measurement. It seems virtually impossible to communicate a clear understanding of the legitimate reasons for these differences – especially to unsophisticated users of the financial statements. The possibility exists for these users to conclude that the higher profit recognized was simply a result of arbitrarily applying a more aggressive accounting method – not a result of applying the most appropriate accounting method in the circumstances. In this case, disclosure of the terms of the transaction and the accounting principle applied should provide financial statement consumers with the most useful information about the impact of land sales on the company's profitability.

Example III -- Capitalization Thresholds
Many companies establish a dollar amount as part of their policies for accounting for property, plant and equipment requiring that no expenditure under such threshold amount be capitalized. These thresholds vary widely between companies, even in the same industry. Would the

proposed rules require a company to report the impact of using each of these different thresholds, a range of thresholds or an estimated average threshold? We believe that more useful disclosure would include transparent information about a company's own policy and threshold. This would allow analysts to evaluate policies and thresholds between companies.
Finally, with respect to the scope of the proposal, we would support a requirement for a company to disclose the reasons for choosing, and the effects of applying, accounting policies used for unusual or innovative transactions or in emerging areas.

To summarize and emphasize our views with respect to the scope of the proposed rules, we strongly support full transparency with respect to principles, policies and assumptions used by a company in its financial reporting. At the same time, we believe that reporting additional measures assuming that the company would use alternative principles and policies would create a great deal of confusion for financial statement users.

Definition of Critical Accounting Estimates

We believe that the criteria set forth in the proposal for identifying critical accounting estimates (CAEs) would result in a wide range of diversity. This is based on the subjective nature of certain of the criteria, including the use of judgment to determine whether assumptions are "highly uncertain" or whether changes in an accounting estimate are "reasonably likely to occur."

As an alternative, the proposed rules could rely on more established and understood criteria contained in existing accounting standards. For example, paragraph 3 of Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*, provides the definition for the terms "probable," reasonably possible," and "remote." In addition, paragraph 17(e) of SFAS 109, *Accounting for Income Taxes*, provides a definition of "more likely than not."

Further, we do not believe the proposed rules should establish a minimum or maximum number of CAEs. We believe that clarifying the definition of CAEs to the extent possible and providing additional examples of CAEs, both in the rule and through subsequent application of the rule, would be far superior to establishing minimum and maximum parameters.

Discussions Between Senior Management and the Audit Committee

NAREIT believes that the Commission's desire to have the audit committees of public companies more involved in the evaluation of critical accounting policies and estimates is appropriate. At the same time, we are concerned that this proposal would expand the amount of time spent by the audit committee in reviewing quarterly and annual financial statements and disclosures. The additional time that may be required to analyze alternatives for the critical estimates and prepare disclosures for the MD&A, and then discuss this information with the audit committee, would make it more difficult for companies to meet the Commission's proposed accelerated filing deadlines. Given the tension between enhanced disclosure and quicker filing, we would strongly recommend that filing deadlines not be accelerated at this time.

A further concern is that this increase in the involvement, responsibility and time commitment of the audit committee also may further fuel reluctance on the part of qualified individuals to serve on audit committees.

Independent Auditor Examinations of MD&A Disclosure Regarding Critical Accounting Estimates

NAREIT believes that the Commission should not require that the CAEs disclosure in the MD&A undergo an auditor examination comparable to that enumerated in Attestation Standard No. 701 (AT 701). The requirements of AT 701 would not significantly enhance what is already required by Statement on Auditing Standards No. 8 (SAS 8), *Other Information in Documents Containing Audited Financial Statements*. SAS 8 requires the auditor to "read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements." Further, we believe that any critical accounting policy and estimates would receive significant focus by auditors in the course of their examination of the company's financial statements. We believe that this auditing standard and focus, along with other disclosures required by the proposed rules and more effective Audit Committee oversight with respect to CAEs, would result in a high degree of assurance that the proposed MD&A disclosures are appropriate and accurate. If the Commission continues to believe that additional assurance is required, NAREIT believes that the final rules should explicitly require that an auditor complete a "review," not an "examination," of the proposed MD&A disclosures in accordance with AT 701.

Quarterly Updates

NAREIT agrees that the rule should require an update of the MD&A information related to CAEs discussed in the company's last filed annual or quarterly report when material developments with respect to the CAEs occur. In addition, we agree that newly identified CAEs should be disclosed in quarterly reports in the same manner as in an annual report.

Disclosures Related to Initial Adoption of Accounting Policies

Although NAREIT agrees that disclosures about the initial adoption of accounting policies would provide useful information to investors and other users of financial reports, we do not believe that companies should be required to disclose the estimated effects of alternative accounting policies that were not adopted. Our views with respect to disclosures related to initial adoption of accounting policies are similar to our views discussed above under "scope of proposal." To reiterate those views, we strongly support full transparency with respect to principles, policies and assumptions used by a company in its financial reporting, but believe that requiring quantitative disclosure based on alternative principles and policies not adopted by companies because they believed them to be inappropriate or inadequate would create a great deal of confusion for financial statement users, even when presented with appropriate cautionary disclosure. In fact, the Commission in the recent past has expressed strong concerns about current pro forma earnings reporting on the basis of possible investor confusion relative to actual performance. These new rules appear contrary to the Commission's views.

NAREIT believes that to ask for a presentation of less appropriate accounting alternatives not selected by a company does not serve to strengthen the financial reporting system. Instead, we believe such disclosures could be unduly confusing to the average financial statement user and could negatively impact a user's desire to read and understand the disclosures that are most relevant to an understanding of a company's results. In addition, we believe such disclosures could mislead financial statement users to conclude that a company is overly conservative or overly aggressive without thoroughly understanding the relationship between the accounting policy used and the substance of the underlying transaction. Finally, we believe that it will be very costly and time consuming to prepare disclosures about the effects of alternative accounting policies and that the costs would exceed the marginal benefit of disclosing these additional measures. Examples of such costs could include the following:

1. internal time to identify and evaluate all alternative accounting policies that could have been chosen;
2. internal time to calculate and analyze the estimated effects for each alternative accounting policy;
3. management time to review the estimated effects of each alternative accounting policy;
4. internal time to prepare the disclosure of the estimated effects of each alternative accounting policy under the plain English rules;
5. increased audit fees for the auditor to provide assurance that all acceptable alternative accounting policies were identified by the client, that the estimated effects were evaluated appropriately in accordance with GAAP and that the disclosure complied with the new rules;
6. increased legal fees for a legal review of such disclosure; and
7. time devoted by the audit committee to review and understand the estimated effects and the disclosure thereof.

Application of Safe Harbors for Forward-Looking Information to the Proposed MD&A Disclosure

As currently proposed, it appears that disclosures made under these new rules would be subject to all of the liability provisions of the Securities Act and the Exchange Act. NAREIT believes that a new, explicit safe harbor should be created for disclosure of CAPs and the accompanying discussion, as well as for accounting estimates that an issuer determines not to disclose because the issuer concludes that the estimate does not meet the definition of a "critical accounting estimate." Although the proposed rules state that the existing safe harbors for forward-looking statements can be relied upon, NAREIT believes that these do not directly or fairly address the new disclosure requirements.

Although the Commission implies that existing safe harbor rules offer adequate protection to companies, it is important to point out that the Private Securities Litigation Reform Act of 1995 ("PSLRA") only provides relief in the context of private actions (as opposed to Commission enforcement actions) and is limited to certain types of transactions (e.g., it does not apply, among other things, to initial public offerings, tender offers or going-private transactions). Similarly, the Commission safe harbor rules under Rule 175 of the Securities Act and Rule 3b-6 of the Exchange Act (which provide that forward looking statements made by or on behalf of a company are deemed not to be fraudulent statements if they are made in good faith and made or reaffirmed with a reasonable basis) are limited in scope and provide only limited protection from liability.

Certain disclosures regarding CAPs will fall within the parameters of traditional forward-looking statements and be protected under the current Commission safe harbors (since some critical accounting policies are simply estimates based upon assumptions of future facts which ultimately may be accurate or not depending on what actually transpires in the future). On the other hand, many types of estimates involve forward-looking statements in an indirect manner or in a manner that is different than the traditional projection. For example, decisions as to whether it is appropriate to capitalize an expenditure or a determination of the fair value of an asset to determine the amount of a write-down do not fit the traditional notion of a forward-looking statement. Inevitably, issuers in the same industry will come up with different estimates for the same assumption, and in any event, no matter how careful or reasonable an estimate, events will occur that will lead to material and unanticipated changes in expected results of operations.

The proposed rules also raise additional liability risks to directors of public companies. At present, the estimates that are implicit in an audited financial report are "expertised" when consent by the auditor is given for the inclusion of the report in the filing. This gives significant liability protection to directors who sign the filing in good faith. On the other hand, the inclusion of a discussion of the accounting estimates in the MD&A discussion would not similarly be expertised, thereby significantly altering the scope of inquiry required of directors in determining whether they satisfied their duties of inquiry in lawsuits based on such disclosures. We believe that requiring different levels of inquiry by directors for similar disclosures based solely on its location in a filing unfairly exposes them to potential liability. Further, we believe that this potential liability involves matters that will in many cases require significant expertise in financial and accounting matters, as well as subtleties of the company's business, that are beyond even what the pending New York Stock Exchange recommendations envision.

By safe harboring the estimates that an issuer makes in good faith, the issuer and its directors will be protected from litigation that does not serve to better the public capital markets, but would not protect issuers from litigation that would compensate those who have lost value due to intentional or reckless inaccurate estimates. Furthermore, by providing a clear and meaningful safe harbor for CAPs, the Commission can encourage more robust and useful disclosure and promote better compliance as they did in the case of the additional disclosures required by Regulation FD and the audit committee report required by Item 306 of Regulation S-K. If legislation is required to establish the safe harbors, the proposed rules should not be adopted until Congress passes such safe harbor legislation and it becomes effective.

Effects on Efficiency, Competition and Capital Formation

The Commission concludes that, although there is some possibility that competitors will be able to infer proprietary or sensitive information from the proposed disclosure, any resulting damage would be mitigated by the fact that all competitors would be subject to the same requirements. NAREIT strongly disagrees with this conclusion. In the case of valuations of properties held for sale or in the estimation of potential liability exposure in litigation situations, NAREIT believes that it is unlikely that all industry participants will be equally exposed. Further, for those companies with material estimates in these areas, ranges of estimates of valuation or potential losses, if disclosed, would significantly undermine the company's bargaining positions in such transactions. For example, a company defending a claim in litigation may believe that the range of settlement amounts is $10 million to $15 million. The company may recognize a loss provision of more than $10 million but would not want this information negatively influencing the final settlement. If a company has legitimate concerns about the proposed disclosures having a negative influence on potential losses, it is possible that many companies will feel themselves forced to rely on "boilerplate" or generalized discussions that would be so imprecise as to only yield uncertainty rather than clarity in the evaluation of the resulting financial statements.

The Commission also concludes that disclosure of the impact of CAPs will improve the efficiency of the capital markets and facilitate capital formation. NAREIT agrees with this conclusion only as it relates to providing disclosures about the company's transactions, accounting policies employed by the company and the sensitivity with respect to significant estimates. We strongly believe that disclosures about the use of alternative policies would result in more confusion rather than more informative disclosure. NAREIT believes that this confusion will result in more uncertainty about the profitability and financial condition of a company and, therefore, thwart the objective of the proposed rules.

Conclusion

In the event the Commission adopts these rules as proposed, NAREIT suggests that the Commission provide for phased-in compliance, with the largest registrants initially complying with the final rules. We suggest that the group of registrants initially required to comply with the proposed rules be similar to the group of companies initially required to provide executive certifications of information in Commission filings pursuant to the Commission's June 27, 2002 order. This approach would provide the Commission an opportunity to review how the rules are implemented and evaluate the usefulness of the disclosures to financial statement users before requiring their adoption by all registrants.

NAREIT appreciates the opportunity to comment on the Commission's proposed rules. If you have any questions regarding this response, please contact me at (202) 739-9432 or Tony Edwards at (202) 739-9408.

Respectfully submitted,

George L. Yungmann
Vice President, Financial Standards