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NAREIT's Best Financial Practices Council Distributes Discussion Paper Seeking Comment on Industry Supplemental Performance Measure

The Council's paper, "Discussion, Potential Modifications, and Requests for Comments Concerning the REIT Industry's Supplemental Performance Benchmark," was distributed to all NAREIT members in June. The paper discusses issues with respect to the current FFO definition and sets forth potential modifications to the measure - including a name change - for comment. The Council encourages all parties to forward their comments to NAREIT no later than August 20, 1999. The discussion paper is available on the web at the members only section of www.nareit.com.

FASB to Permit Per-Share Figures to Account for Goodwill

As part of its business combinations project, the FASB tentatively has decided to permit the reporting of per-share amounts on the face of the income statement for goodwill amortization (net-of-tax) and the subtotal that precedes that amount. Responding to pooling-of-interests proponents, companies with goodwill amortization would be permitted to display a subtotal "income from continuing operations before goodwill amortization," followed by the goodwill amortization expense as a separate line item within income from continuing operations. This decision is significant for REITs and publicly traded real estate companies since it may indicate that the FASB is open to reporting per-share amounts for significant subtotals of net income. *The Wall Street Journal* characterized the move as an indication that the FASB "is heading toward a broader acceptance of 'cash' EPS."

NAREIT plans to support the Board's conclusion regarding additional per-share reporting and intends to propose that our industry's additional performance measure also be subject to per-share reporting. The proposed Statement on business combinations is expected to be released for a 90-day public-comment period in August 1999. NAREIT plans to form a task force upon issuance of the Exposure Draft to prepare a comment letter. Anyone interested in participating should contact David Taube at (202) 739-9442 or dtaube@nareit.com. Public hearings to discuss comments are planned for the beginning of 2000, with issuance of a final standard anticipated in the latter part of the year.

During recent deliberations, the FASB determined that its conclusions regarding the methods of accounting for business combinations should be effective for transactions initiated after the date of issuance of the final standard. Business combinations initiated prior to issuance of the final standard will be grandfathered under APB Opinion No. 16, *Business Combinations*. The FASB also decided to eliminate the requirement under Opinion 16 that companies disclose pro forma results of operations for the current and immediately preceding period. Several tentative decisions on key issues have been modified:

- When the fair value of the acquired net assets exceeds the fair value of the purchase consideration (excess fair value), the values assigned to purchased intangible assets that do not have a readily determinable market value would be limited to the amount that would not create or increase an excess fair value. Any remaining excess fair value should be allocated as a pro rata reduction of the values that would otherwise be assigned to depreciable non-financial assets and other intangible assets. If any excess fair value remains after those assets are reduced to zero, it would be recognized as an extraordinary gain. This modifies the previous decision that the entire excess fair value would be accounted for in a manner similar to an extraordinary gain.

- The presumption that goodwill has a useful life of 10 years or less has been eliminated. However, the requirement that the amortization period cannot exceed 20 years was retained.
- Intangible assets that are separable can be amortized over periods greater than 20 years provided that (a) the finite useful economic lives of the assets exceed 20 years and (b) the useful economic lives are supported by clearly identifiable cash flows. The requirement that there be an observable market for the intangible assets was dropped.

International Accounting Standards Committee Seeks Comment on Fair Value Accounting for Investment Property

The International Accounting Standards Committee (IASC), the organization that determines accounting standards for many countries outside the U.S., has voted to issue an Exposure Draft proposing fair-value accounting for investment property held for lease and/or capital appreciation. Under the proposal, investment property would be carried on the balance sheet at fair value, with unrealized gains and losses from changes in fair value reported in quarterly and annual income statements. Outside appraisals to determine fair value would be encouraged but not required.

NAREIT is forming a task force to consider preparing an industry comment letter responding to the IASC proposal. Anyone interested in participating should contact David Taube at (202) 739-9442 or dtaube@nareit.com. The deadline for comment is October 31, 1999, with adoption of a final standard planned in the early part of 2000. The Exposure Draft is available on the web at www.iasc.org.uk.

NAREIT Submits Industry Response to FASB Exposure Drafts on Stock Options and Consolidations

In May, NAREIT formed a Stock Compensation Task Force to respond to the FASB's proposed interpretation of APB Opinion No. 25, *Accounting for Stock Issued to Employees*. The interpretation of APB 25 is intended to address application issues and provide accounting guidance as to whether APB 25 or FASB Statement No. 123, *Accounting for Stock-Based Compensation*, is the appropriate standard to follow in certain transactions involving stock compensation granted to employees. The FASB plans to issue a final interpretation in the fourth quarter of 1999.

In late June, the task force forwarded its dissent to the FASB regarding the interpretation's proposed guidance on accounting for stock-based compensation to independent directors and employees of unconsolidated subsidiaries. Under the proposal, independent directors and employees of unconsolidated subsidiaries would not be considered employees of the company, thereby not permitting accounting under Opinion 25 for stock-based compensation. Since many NAREIT member-companies have employees in unconsolidated preferred stock subsidiaries providing key real estate services, the task force requested that the FASB provide an exception to the interpretation for these employees.

Also in May, NAREIT's Consolidations Task Force submitted its comment letter opposing the FASB's proposal on criteria for when the financial statements of related companies must be consolidated. In general, the proposal would require a parent company to consolidate its subsidiaries that are deemed controlled, including relationships involving corporations, partnerships, trusts, or other unincorporated entities. Contrasted with today's practice in which consolidation is generally based on the percentage of voting shares held by the parent company, the proposed statement would require consolidation when a company has the non-shared ability to direct the policies and management of another entity, so as to increase benefits and limit losses.

The opposing position taken by NAREIT's task force to the consolidation criteria resulted from the FASB's insistence that control or effective control, without regard to the materiality of the parent's economic position in the subsidiary, is sufficient criteria for one business enterprise to consolidate another business enterprise. The task force focused its concern on the potential for "grossing up" the financial statements when consolidation would be required by a general partner with nominal interests in a limited partnership or a partner with less than a majority interest in a joint venture. As an alternative to the subjective criteria proposed by the FASB, the task force suggested a minimum economic threshold of twenty (20) percent for when consolidation and the attendant control issues would be considered.

Both task forces' submissions are available on the web at the members only section of www.nareit.com.

FASB Approves One-Year Deferral of Statement on Derivatives and Hedging

Outcry by auditors and financial statement preparers with respect to the complexities associated with the provisions of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as well as required system modifications related to the year-2000 issue, influenced the FASB to vote for a one-year postponement in the effective date of the Statement to all fiscal quarters of all fiscal years beginning after June 15, 2000. In mid June, NAREIT sent the FASB its concurrence with the proposal. This letter is available on the web at the members only section of www.nareit.com.

FASB Issues Interpretation on Real Estate Sales Accounting

The FASB issued an Interpretation of Statement No. 66, *Accounting for Sales of Real Estate*, that clarifies the phrase "all real estate sales" to include sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. Examples cited include office buildings, manufacturing facilities, power plants, and refineries. The Interpretation applies to all sales of real estate with property improvements or integral equipment entered into after June 30, 1999. The Interpretation clarifies that the Statement applies to all real estate sales without regard to the nature of the seller's business.

This clarification should have little impact on real estate companies. Although the real estate industry has been applying the Statement, companies in other industries have taken the position that it did not apply to them.

FASB Releases Proposal to Amend Statement 125 Dealing with Transfers of Financial Assets

The FASB has issued an Exposure Draft to amend FASB Statement 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. The proposal would clarify criteria and expand guidance for deciding whether the transferor has relinquished control of the assets and the transfer is therefore accounted for as a sale. It also would change the accounting and related disclosures about collateral, as well as require enhanced disclosure about securitizations.

The amendment would apply to all transfers of financial assets occurring after December 31, 2000 and would be applied prospectively. Revised securitization disclosures would be required for fiscal years ending after December 15, 2000. The FASB is accepting comments on the proposal through September 27, 1999. NAREIT will be discussing this proposal with its Accounting Committee and other NAREIT members to evaluate whether a response is warranted. If you have any comments, please contact David Taube at (202) 739-9442 or dtaube@nareit.com.

NAREIT Provides Guidance on Reporting Performance on a per Share Basis

Diversity in practice in reporting FFO per share prompted NAREIT to issue a National Policy Bulletin on "Reporting Performance on a Per Share Basis." Under the direction of NAREIT's Best Financial Practices Council, NAREIT developed guidance for reporting per share performance consistent with FASB Statement No. 128, *Earnings Per Share.* The guidance includes real estate specific examples on how to treat "potential common shares" that are dilutive to EPS, but not FFO per share, as well as operating partnership units and related minority interests. The Bulletin is available at the members only section of www.nareit.com.

SEC Provides Guidance on Disclosure of Non-GAAP Measures and Reporting Requirements for Acquired Properties

The SEC's Division of Corporate Finance recently provided guidance on frequently requested accounting and financial reporting issues including disclosure of non-GAAP measures and financial statement requirements for acquired operating properties. The following is a summary of the guidance issued. Please refer to web address www.sec.gov/offices/corpfin/cfactfaq.htm for the complete text of this guidance.

Disclosure of Non-GAAP Measures

Although the SEC recognizes that presentation of non-GAAP financial measures such as Funds From Operations (FFO) can be useful, it is concerned that an "unbalanced presentation" could confuse investors and lead to undue reliance on the measure. The SEC previously addressed problems associated with presenting non-GAAP measures in Accounting Series Release No. 142 and recently highlighted frequent areas of concern regarding disclosures and practices:

- Presentation of a non-GAAP measure should be in a manner that does not give it greater authority or prominence than GAAP net income or cash flows.
- Whenever a non-GAAP measure is used, a footnote or other reference to a complete explanation of its calculation and components should be included. The footnote or other disclosure should state that the measure may not be comparable to similarly titled measures reported by other companies.
- To ensure balance and avoid undue reliance on non-GAAP measures, management should consider how the measures are expected to be used by investors, identify significant factors that should be considered, and discuss significant trends or requirements not captured by the measures.
- Non-GAAP measures calculated to reflect "cash" or "funds" generated by operations (i.e., liquidity) should be balanced with equally prominent disclosure of amounts from the statement of cash flows (e.g., cash flows from operations, investing and financing activities) and, if relevant, the ratio or deficiency of earnings to fixed charges.
- A non-GAAP measure should be presented in an appropriate context with clarification of its expected use. The use of a non-GAAP measure in a discussion of operating performance when the measure is primarily a measure of liquidity, capital resources, or debt service capacity is inappropriate.
- When the non-GAAP measure is presented as an alternative or pro forma measure of performance, to achieve consistency in periodic reporting, no adjustments should be made to eliminate or smooth items characterized as nonrecurring, infrequent or unusual.

Reporting Requirements for Acquired Properties

The SEC reiterated guidance on financial statements required by Rule 3-14 of Regulation S-X in Form 8-K and transactional filings (i.e., registration statements and proxies) for acquired operating real estate properties. In addition, the SEC also provided guidance on when the financial statements of properties subject to a long-term net lease may be omitted from a filing. This may be permitted when the property will be leased on a long-term basis immediately after its acquisition to a single tenant under a net lease that transfers substantially all of the property's non-financial operating and holding costs to the tenant. In this scenario, financial and other data about the lessee or guarantor may be more relevant to investors than the acquired property financial statements.

SEC Offers Y2K Testing for EDGAR Filers

The SEC is providing EDGAR filers the opportunity to use an EDGAR Y2K test system from July 12 through July 30 for voluntary submission of test filings. By setting the EDGAR system to a Y2K date, the SEC will allow filers to test their EDGAR filing equipment and procedures. Companies that outsource SEC filings should consider requiring their vendor to take advantage of the testing. The SEC's EDGAR Filer Support can be contacted at (202) 942-8900. Test information and instructions are available on the SEC website at www.sec.gov/edaux/news/edy2ktst.htm.

NAREIT CFO Workshop

Mark your calendar for NAREIT's third annual CFO Workshop in Reston, Virginia at the Hyatt Regency Reston on November 15 and 16. The program begins on the evening of November 15th with a reception and dinner discussion. The following day will include a full program featuring detailed sessions on accounting and finance issues designed exclusively for corporate member financial executives, such as CFOs, Controllers, Treasurers, Vice Presidents of Finance and Chief Accounting Officers. Look for program information in the mail in upcoming months.

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Any questions about industry accounting and financial reporting practices should be directed to George Yungmann, Senior Advisor, Financial Standards, at (202) 739-9438 or gyungmann@nareit.com, or David Taube, Financial Standards Analyst, at (202) 739-9442 or dtaube@nareit.com.