NAREIT

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In this issue:

- AcSEC Advances Cost Capitalization ED
- FEI Earnings Release Guidance
- Update on FASB Activities
  - Asset Impairment-Held-for-Sale Accounting
  - Business Combinations - Joint Ventures/ Goodwill Impairment
  - FASB 140
  - Fair Value Accounting for Financial Instruments
  - Disclosure Redundancies
  - Standards Overload
- SEC Comments, Rules and Guidance
  - Financial Reporting Issues in 2001
  - Enhanced Equity Compensation Disclosure Proposed
  - Fair Disclosure Roundtable
- NAREIT Law & Accounting Conference

Meeting Notice

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What: NAREIT Accounting Committee
Where: Law & Accounting Conference
The Renaissance Washington Hotel
Renaissance Ballroom West
Washington, D.C.
When: Wednesday, May 2, 2001, 2:30-4:00 pm

AcSEC Advances Cost Capitalization ED

The AICPA staff moved one step closer to issuing an Exposure Draft (ED) of its proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment,* by formally submitting it to the Financial Accounting Standards Board (FASB) to obtain clearance. A Board meeting to review the proposal has been scheduled for 1 p.m. (EDT) on Wednesday, April 11.

Assuming the FASB provides clearance, an ED of the SOP is anticipated to be issued for public comment within a month. The SOP will include capitalization accounting guidance for property, plant and equipment (PP&E) for all industries, as well as the accounting for costs related to major repairs and maintenance expenditures (in some industries known as overhauls and turnaround costs).

With the proposal's potential negative impact on the net income and FFO of real estate companies, NAREIT will be requesting that each member company develop a response and share its and NAREIT's views on the ED with its audit firm. To assist companies in this effort, NAREIT's Cost Capitalization Task Force plans to complete and distribute a comment letter shortly after the issuance of a public ED. NAREIT's task force and staff will be prepared to help companies identify the issues to be addressed in a comment letter.

FEI Earnings Release Guidance

At the suggestion of the Securities and Exchange Commission (SEC), Financial Executives International (FEI) is drafting best practices recommending that earnings releases should focus on earnings per share (EPS) as defined by generally accepted accounting principles (GAAP), not pro forma results or earnings before non-cash expenses. According to a *Wall Street Journal* article, concerns about the increased number of companies using creative accounting to give the appearance of enhanced profitability prompted this initiative. Specifics of the proposal are expected shortly on FEI's web site (www.fei.org).

Update on FASB Activities

Asset Impairment - Held-for-Sale Accounting

In its deliberation of its asset impairment and disposal proposal issued in July 2000, *Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities*, the FASB has tentatively decided to amend certain aspects related to held-for-sale accounting. Assets or asset groups classified as held for sale are measured at the lower of carrying amount or fair value less cost to sell. As drafted,

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the proposal would permit held-for-sale accounting if a plan of sale meets certain criterion, including that the sale of the asset or asset group be completed within one year. The FASB determined that an exception to the one-year limit should apply under the following conditions:

- the company actively solicited offers during the initial one-year period, but did not receive any reasonable offers, and the price was subsequently reduced to reflect that change in circumstances;

- the asset continues to be actively marketed at a price that is reasonable and reflects the change in circumstances; and

- the other criterion for held-for-sale accounting continues to be met.

In its review of the conditions in which an exception to the one-year criteria would apply, the Board affirmed its position that no exceptions would be permitted for assets acquired through foreclosure.

In a related matter, the FASB decided that the sale of an asset or the settlement of a liability previously classified as held for sale as part of a group would not require that the remaining assets and/or liabilities be measured individually, so long as the other criterion for held-for-sale accounting continued to be met. The original proposal required that remaining assets be held for sale and measured individually at the lower of their carrying amounts or fair values less cost to sell, while remaining liabilities would be measured individually at their carrying amounts.

NAREIT's Asset Impairment Task Force addressed this issue in its October 2000 comment letter (available under Accounting Issues in the Members Only section of www.nareit.com):

> NAREIT believes that the final standard should permit one-off asset sales and liability settlements that do not otherwise change management's initial plan to sell the group of assets and liabilities. The one-off asset sales or settlements should not disqualify the continued grouping of the remaining assets and liabilities so long as all other criteria continue to be met.

In its guidance, the Board intends to make clear that if more individual assets or liabilities were subsequently removed from the group, only in rare circumstances would the criteria for held-for-sale accounting treatment be met. Any additional asset sales or liability settlements would bring into question the commitment to sell the assets as a group.

A final standard addressing impairment of long-lived assets and assets to be disposed is expected to be issued in the fourth quarter of 2001.

Business Combinations - Joint Ventures/Goodwill Impairment Proposal

As part of its final standard on business combinations, the FASB also intends to address certain issues related to joint ventures. The Board tentatively decided that goodwill related to an equity method investment should not be amortized after the new standard is adopted. It also was determined that goodwill related to an equity method investment should not be separately tested for impairment; rather, the carrying value of the investment should continue to be reviewed for impairment in accordance with paragraph 19(h) of APB No. 18, *The Equity Method of Accounting for Investments in Common Stock.*

Although the Board concluded that a joint venture formation transaction would be excluded from the scope of the business combinations guidance, during recent deliberations, it was decided that the definition of corporate joint ventures as provided in paragraph 3(d) of APB 18 would be retained. Other issues related to existing joint ventures guidance to be considered in the near future include: (1) the degree to which each joint venture owner must participate in management of the entity; (2) whether a joint venture owner must be a business or government (versus an individual person); and (3) whether certain events or transactions that are planned as of the date the joint venture is formed or that occur

thereafter would require that the joint venture formation be accounted for a business combination.

In connection with its decision to adopt an impairment-only approach for the amortization of goodwill, in February 2001 the FASB issued a “limited-exposure” proposal on its tentative decisions related to the accounting for goodwill. This follows the Board’s unanimous vote to eliminate the pooling-of-interests method of accounting for business combinations.

Under the impairment-only approach, if the fair value of goodwill of a “reporting unit” falls below its carrying amount, an impairment loss would be charged against earnings. A benchmark assessment providing for future impairment reviews would be performed within one year of the acquisition date if the amount of goodwill is significant to the reporting unit. Subsequent impairment reviews only would be required upon the occurrence of events indicating that goodwill of the reporting unit might be impaired. A “transitional” benchmark assessment also would be required for all existing reporting units with goodwill within six months of the date of adoption of the standard. An impairment loss recognized as the result of a transitional benchmark assessment would be included in the measurement of income from operations, not as a cumulative effect of a change in accounting principle.

The decision to no longer require the amortization of goodwill represents a significant change to the stance in the December 1999 business combinations ED, which would have required purchased goodwill to be amortized over no longer than 20 years. Also noteworthy is the related decision to cease the amortization of goodwill arising from acquisitions completed before the effective date of the new standard. Pre-existing goodwill also would be subject to the foregoing impairment review. Goodwill would be presented as a separate line item in the balance sheet and goodwill impairment charges would be presented as a separate line item in the operating section of the income statement unless the goodwill impairment loss is associated with a disposition or a discontinued operation.
In other related deliberations, the Board retained the requirement for disclosures of pro forma information provided for in APB No. 16, *Business Combinations*, while adding the requirement that the pro forma information be disclosed in the notes to condensed interim financial statements. It also was decided that unamortized negative goodwill related to APB 16 should be recognized as an extraordinary gain upon adoption of the standard.

A copy of the “limited-exposure” proposal is available on the web at http://accounting.rutgers.edu/raw/fasb/ or from the FASB Order Department at (800) 748-0659. A final business combinations standard is expected in July 2001. Business combinations initiated subsequent to the issuance of the standard would be accounted for using the purchase method.

FASB 140

SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Liabilities,* became effective on April 1, 2001. The Statement replaces SFAS No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and revises the standards for accounting for securitizations and other transfers of financial assets and collateral. Some industry participants believe that the new standard will have negative impacts on the commercial mortgage-backed securities (CMBS) market. A coalition of these participants forwarded a letter to the FASB on March 20. A copy of this letter can be found at http://www.bondmarkets.com/regulatory/FAS140assocltr32001.shtml. These industry participants are discussing, with the FASB, the application of the new standard to CMBS transactions.

Financial Instruments - Fair Value Accounting

As part of its long-term project on fair value accounting for financial instruments, the FASB has decided to implement “near-term” measures that would improve disclosures about financial instruments. In an effort to make the disclosures more useful and meaningful, the FASB will revise the disclosure requirements in SFAS No. 107, *Disclosures About Fair Value of Financial Instruments.* No timetable has been set for completion of the work.

As part of the long-term project, the FASB also decided to prepare a discussion paper for internal use that would consider how changes in fair value of such instruments should be reported. This comes after the December 2000, release by the FASB of a Special Report, *Financial Instruments and Similar Items,* prepared by the Financial Instruments Joint Working Group (JWG). The JWG is comprised of representatives from standard setting bodies in Australia, Canada, France, Germany, Japan, New Zealand, five Nordic countries, the U.K., and the U.S., as well as the International Accounting Standards Committee. The Special Report recommends certain changes to accounting for financial instruments and other similar items. Although the Special Report is not on the FASB's formal agenda, it hopes to gain insight from any comments received. The Special Report is available on the web at http://accounting.rutgers.edu/raw/fasb/new/index.html, or from the FASB Order Department at (800) 748-0659. The comment letter deadline is June 30, 2001. NAREIT will be discussing this issue with its Accounting Committee and other NAREIT members to determine whether the formation of a task force and response is warranted.

Disclosure Redundancies

A FASB panel studying how financial reports can be improved, known as the Business Reporting Research Project, in March 2001 released a report focusing on redundancies in financial statements and notes required by GAAP and disclosure requirements of the SEC. The report (available on the web at http://accounting.rutgers.edu/raw/fasb/ or from the FASB Order Department at (800) 748-0659) was sent to the FASB, SEC, and AICPA with the hope that they would eliminate existing redundancies and prevent their formation in the future.

The report recommends improving the structure and organization of disclosures within Form 10-K and provides a model Form 10-K to illustrate its suggestions. Disclosure redundancies identified in the report are related to income taxes, major customers, contingencies, financial instrument risks, related-party transactions, R&D development expenses, and allowances for doubtful accounts. Neither the FASB, SEC, nor AICPA have set a timetable to act on the report's recommendations.

Standards Overload

Citing concerns raised by companies and their auditors about the surge in the number of new and greater detailed rules from the FASB, SEC, and AICPA, the Financial Accounting Standards Advisory Council (FASAC) has initiated discussions on what it terms "standards overload." The FASAC, which is the panel that advises the FASB, is concerned about the lack of "one good, single source" for rules on a specific accounting topic. Further consideration of the issue is planned for a future meeting.

SEC Comments, Rules, and Guidance

Financial Reporting Issues in 2001

In a March 2, 2001, speech at The Practicing Law Institute's "The SEC Speaks in 2001" conference, the Chief Accountant of the SEC's Division of Corporation Finance, Robert A. Bayless, focused on accounting and disclosure issues that are expected to be scrutinized by the SEC staff during their review of year 2000 annual filings. He indicated that annual reports would have a better chance of being reviewed as a result of the slowdown in initial public offerings.

Disclosures that Bayless mentioned included requirements related to segments, market risk, credit risk, derivatives and hedging (SFAS No. 133), securitized financial assets (SFAS No. 140), and intangible assets. Accounting issues that would be subject to examination include impairments; losses required due to an "other-than-temporary" decline in the value of debt or equity securities available-for-sale or accounted for at cost; and revenue recognition. He also suggested that it would be a good time for companies to take a fresh look at MD&A and the Description of Business section, emphasizing that the underlying causes and their relationship to the long-term value of the business be discussed, rather than simply reciting amounts and changes apparent on the face of the financial statements.

Enhanced Equity Compensation Disclosure Proposed

On January 26, 2001, the SEC published for public comment a proposed rule, *Disclosure of Equity Compensation Plan Information*, which would amend the disclosure requirements applicable to proxy statements and periodic reports. The proposal seeks to enhance disclosure of the number of securities authorized for issuance under equity compensation plans. Specifically, the amendments would require disclosure in a registrant's proxy statement or annual report on Form 10-K or 10-KSB of the following information:

- the number of securities authorized for issuance under each equity compensation plan of the registrant in effect as of the end of the most recently completed fiscal year;

- the number of securities issued pursuant to equity awards made during the last completed fiscal year, plus the number of securities to be issued upon the exercise of options, warrants or rights granted during the last completed fiscal year, under each plan;

- the number of securities to be issued upon the exercise of outstanding options, warrants or rights under each plan; and

- other than securities to be issued upon the exercise of outstanding options, warrants or rights, the number of securities remaining available for future issuance under each plan.

The information would be provided without regard to whether the company's shareholders previously approved the equity compensation plan. Companies would be required to identify which of the equity compensation plans was adopted without security holder approval and provide a brief, narrative description of the material features of each plan adopted without security holder approval during the last completed fiscal year.

The complete text of the proposal is available on the web at http://www.sec.gov/rules/proposed/33-7944.htm.

Fair Disclosure Roundtable

The SEC will hold a public roundtable to discuss the new Regulation Fair Disclosure on April 24, 2001, from 10 a.m. to 4:00 p.m., at the Alexander Hamilton U.S. Customs House Auditorium, One Bowling Green, in New York City. Acting SEC Chairman Laura S. Unger will moderate a discussion to review the initial experiences of issuers, analysts and investors with the fair disclosure regulation.

NAREIT Law & Accounting Conference

Final arrangements are being made for NAREIT's 2001 Law & Accounting Conference to be held on May 2-4 at The Renaissance Washington Hotel, Washington, D.C. The Conference is the best way for real estate executives and others to keep abreast of financial reporting, legal, and tax developments affecting the industry. Some of the accounting topics to be presented include internal auditing, ambiguous practices, joint ventures, and derivatives. Registration materials were recently distributed. If you have any questions, please contact Natalie Williams at (202) 739-9400 or nwilliams@nareit.com, or you can register online at www.nareit.com.

Any questions about industry accounting and financial reporting practices should be directed to George Yungmann, Vice President, Financial Standards, at (202) 739-9432 or you may send email to: gyungmann@nareit.com, or David Taube, Director, Financial Standards, at (202) 739-9442 or you may send email to: taube@nareit.com.