

Update



NATIONAL ASSOCIATION OF REAL ESTATE INVESTMENT TRUSTS®

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SEC

Issues Guidance On Non-GAAP (FFO) Reporting

On June 13, 2003, the SEC issued *Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures*. Click [HERE](#) to access the FAQ. The answers to these questions represent the views of the Division of Corporate Finance rather than formal Commission rules or regulations. Question 7 of the FAQ addresses the SEC's reference to the term "funds from

operations" in its recent rule concerning companies' use of non-GAAP financial measures. Click [HERE](#) to access the rule.

The specific question in the FAQ is:

What measure was contemplated by "funds from operations" in footnote 50 to the adopting release, which indicates that companies may use "funds from operations per share" in earnings releases and materials that are filed or furnished to the Commission, subject to the requirements of Regulation G and Item 10(e) of Regulation S-K?

The complete answer is:

Footnote 50 contemplated only the measure "funds from operations" defined and clarified, as of January 1, 2000, by the National Association of Real Estate Investment Trusts. Footnote 50 did not contemplate measures that contain modifications from the measure "funds from operations" as so defined and clarified. Accordingly, the use of such a modified measure, or a per share amount based on such a modified measure, in materials filed with the Commission would be subject to all of the provisions of Item 10(e) of Regulation S-K.

Based on a number of discussions with senior SEC officials at the Division of Corporate Finance, it is clear that the SEC did **not** intend to limit its reference to FFO as defined by NAREIT as of January 1, 2000. The SEC staff advised us

that footnote 50 of the Rule contemplated the measure of FFO as **currently** defined and clarified by NAREIT. Click [HERE](#) to access NAREIT's Financial Reporting Alert regarding this clarification.

Issues Rules Relating to Improper Influence on Conduct of Audits

Pursuant to Section 303 of the Sarbanes-Oxley Act of 2002, effective June 27, 2003, the SEC adopted rules to prohibit officers and directors of an issuer, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate, mislead, or fraudulently influence the auditor of the issuer's financial statements if that person knew or should have known that such action, if successful, could result in rendering the financial statements materially misleading. The rule, in combination with the existing rules under Regulation 13B-2, are designed to ensure that management makes open and full disclosures to, and has honest discussions with, the auditor of the issuer's financial statements. These rules prohibit officers or directors of an issuer, or persons acting under their direction, from subverting the auditor's responsibilities to investors to conduct a diligent audit of the financial statements and to provide a true report of the auditor's findings. Click [HERE](#) to access the final rules.

As reflected in the final rule, the SEC agreed with NAREIT's suggestion to acknowledge that a change in audit firm by a company does not by itself imply a violation of the rule. Also, consistent with our comments, the SEC did not change the "under the direction of" language. The proposal had asked if this language should be changed to "at the behest of" or "on behalf of." In our comment letter, we indicated that this change in language would indicate that no specific direction by an officer or director is required to violate the rules. We do not believe

that an officer or director should be held responsible for fraudulent acts of subordinates unless such action was taken at the specific direction of the officer or director. Click [HERE](#) to access NAREIT's comment letter dated November 25, 2002.

Issues Standards on Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, on June 5, 2003, the SEC adopted rules requiring companies subject to the reporting requirements of the Securities Exchange Act of 1934, other than registered investment companies, to include in their annual reports a report of management on the company's internal control over financial reporting.

The internal control report must include: a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company; management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of the company's most recent fiscal year; a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and a statement that the registered public accounting firm that audited the company's financial statements included in the annual report has issued an attestation report on management's assessment of the company's internal control over financial reporting. Under the new rules, a company is required to file the registered public accounting firm's attestation report as part of the annual report.

Furthermore, the SEC added a requirement that management evaluate any change in the company's internal control over financial



reporting that occurred during a fiscal quarter that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting. Finally, the SEC adopted amendments to its rules and related forms to revise the Section 302 certification requirements and to require issuers to provide the certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 as exhibits to certain periodic reports. Click [HERE](#) to access the final rules.

While the effective dates for complying with these new standards vary based on whether or not a company is an accelerated filer, most NAREIT member companies must begin to comply with the management report on internal control over financial reporting disclosure requirements in their annual reports as of the end of their first fiscal year ending on or after June 15, 2004. Therefore, most NAREIT member companies must begin to comply with the requirements regarding evaluation of any material change to its internal control over financial reporting in 1st Q05 quarterly reports.

Approves New NYSE and NASDAQ Rules Requiring Shareholder Approval of Equity Compensation

On June 30, 2003, the SEC approved new rules proposed and adopted by the New York Stock Exchange (NYSE) and the NASDAQ Stock Market (NASDAQ) requiring shareholder approval of equity compensation plans, including stock option plans. The new rules also will require shareholder approval for repricings and material plan changes.

The new rules will provide, for the first time, comprehensive shareholder approval requirements for these plans for companies subject to the listing standards of the NYSE and NASDAQ. The

NYSE's new rules will replace its current pilot program, which exempted "broad-based" equity compensation plans from a shareholder approval requirement. The Commission also approved a change in the NYSE rules for voting shares held in "street name" on equity compensation plans. The change will permit a broker that is a member of the Exchange to vote for or against those plans only when the broker receives instructions from the beneficial owner of the voting securities. Click [HERE](#) to access the new rules. The final rules apply to all new plans and old plans that are materially modified after June 30, 2003.

NAREIT

Submits Letter to FASB Regarding AICPA's Proposed "Cost Capitalization" SOP

On July 9, 2003, NAREIT submitted a letter to the FASB expressing its continuing concerns regarding the AICPA's pending proposal that would impact the accounting for property, plant and equipment (PP&E) in all industries. Click [HERE](#) to access a revised draft of the proposed SOP. This latest draft generally echoes conclusions reached in the June 2001 exposure draft - despite 400 comment letters that generally objected to the conclusions in that draft. The proposal continues to implicitly eliminate the composite method of accounting for PP&E, limits the types of costs that could be capitalized, and eliminates the "lease-up" accounting practice that allows the capitalization of carrying costs during a project's lease-up phase. The draft indicates an effective date of 2005 for calendar year companies.

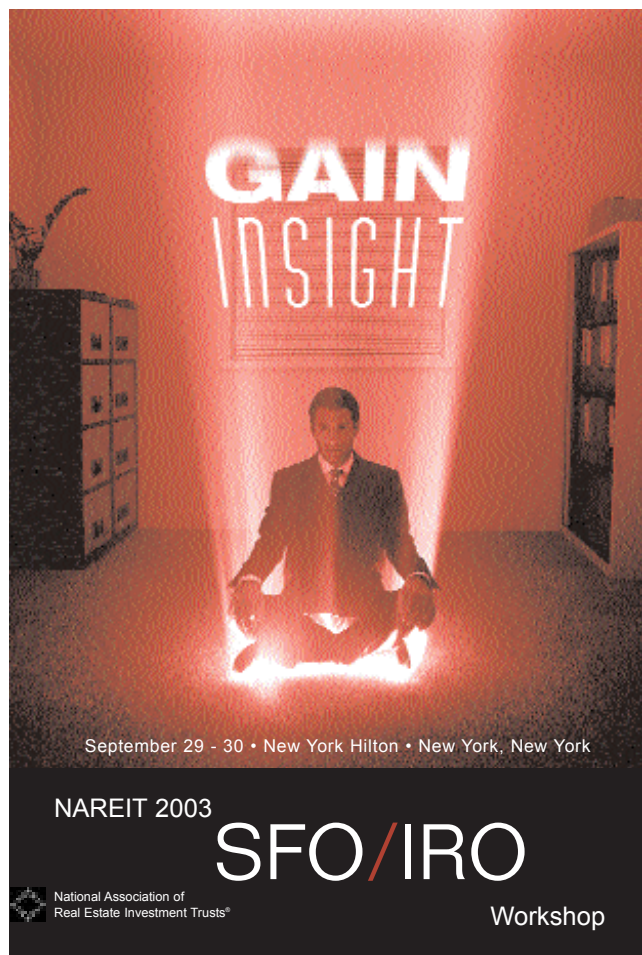
NAREIT's letter to the FASB makes two main points: 1) the proposed rules will lead to greater, rather than lesser, diversity in accounting for capital expenditures (contrary to the initial SEC concern), and 2) the proposal is at odds with the

harmonization of U.S. accounting standards with global standards. In addition, the letter requests a meeting with the FASB. Click [HERE](#) to access NAREIT's letter.

NAREIT 2003 SFO/IRO Workshop

The 2003 SFO/IRO Workshop will be held on September 29 and 30 at the New York Hilton in New York. The program will include three general sessions and eight concurrent sessions, providing a broad range of learning experiences

for senior financial officers and investor relations officers. Sessions will cover the new corporate governance and financial reporting environment, the current capital markets and best practices with respect to investor relations. The program is designed exclusively for corporate member financial executives, such as CFOs, Controllers, Directors of Investor Relations, Treasurers, Vice Presidents of Finance and Chief Accounting Officers. Invitations to the workshop will be mailed in July.



National Association of Real Estate Investment Trusts

Steven A. Wechsler
President and CEO

Financial Standards/SEC Team

Tony M. Edwards
Senior Vice President and General Counsel
(202) 739-9408
tedwards@nareit.com

George L. Yungmann
Vice President, Financial Standards
(202) 739-9432
gyungmann@nareit.com

Robert R. Cohen
National Policy Counsel
(202) 739-9415
rcohen@nareit.com

Gaurav Agarwal
Director, Financial Standards
(202) 739-9442
gagarwal@nareit.com