

# Alert



National Association of Real Estate Investment Trusts®

## New GAAP Requirement for Reporting Property Sales

### Affects FFO and GAAP Income

The Financial Accounting Standards Board (FASB), on February 20, 2002, resolved an implementation issue with respect to Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, that in most cases, requires that gains/losses from dispositions of investment properties and all operating earnings from these properties be reported as “discontinued operations.” As a result, effective immediately, gains/losses and earnings related to these properties will be excluded from Funds From Operations (FFO), “Operating Earnings” and Income From Continuing Operations since the current definition of each of these measures excludes amounts reported as discontinued operations. This standard does not apply to dispositions of inventory—property developed and held for sale, such as “build to suits” and land developed for sale. See FASB Alert No. 02-09 (Feb. 27, 2002)  
<http://www.fasb.org/action/aa022702.html>

### No Restatement of Net Income Required

It is important to emphasize that this new reporting standard does not require a restatement of previously reported, bottom-line Net Income. However, as further discussed below, it does require reclassification of certain amounts from Income from Continuing Operations to discontinued operations.

Of further importance to NAREIT member companies, this change causes Income From Continuing Operations to be the same as Operating Earnings, the metric recently agreed to by analysts. Said another way, income before the three “below-the-line items” defined by Generally Accepted Accounting Principles (GAAP) will be equivalent to the analysts’ Operating Earnings. The three below-the-line items include: extraordinary items, results of discontinued operations and cumulative effects of accounting changes. Also, because amounts reported as discontinued operations are reported net of any applicable taxes and minority interests, the complication of adjusting gains/losses for these related amounts has been eliminated. Further, most gains/losses and earnings related to properties disposed of by a joint venture will be reported as discontinued operations and, therefore, excluded from the partner’s Income from Continuing Operations.

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## Reclassification as Discontinued Operations May Create Confusion

Reporting gains/losses as discontinued operations represents a significant step in bringing REIT FFO reporting more in line with GAAP metrics. At the same time, the new standard could cause some confusion from the reclassification of previously reported earnings to the discontinued operations line on the income statement. The new standard requires that all earnings, past and future, applicable to an investment property disposed of or transferred to the “held for sale” category on the balance sheet be reported as discontinued operations. This will result in previously reported Operating Earnings and Income From Continuing Operations being updated each time an investment property is disposed of or transferred to a held for sale category. For companies that regularly sell properties, this constant revision to previously reported metrics may result in some level of confusion among financial statement users.

## FASB Rejected Different Approach

Because of this potential confusion, NAREIT and a number of the accounting firms advocated to the FASB that only major dispositions of

properties or groups of properties be covered by the new standard. On February 20, 2002, the FASB considered and rejected this modification to the standard. Therefore, while general materiality guidance should be applied to this new standard, it will be applicable to most dispositions of individual or groups of investment properties beginning in the current quarter—the first quarter of 2002.

## Questions

If you have any questions regarding this new reporting, please contact George Yungmann at 202-739-9432 or [gyungmann@nareit.com](mailto:gyungmann@nareit.com), or David Taube at 202-739-9442 or [dtaube@nareit.com](mailto:dtaube@nareit.com).

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