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NAREIT Financial Reporting
ALERT

National Association of Real Estate Investment Trusts®

Further Guidance on Reporting FFO

Over the past several months a number of questions have been raised with respect to reporting Funds From Operations (FFO). Member companies, NAREIT staff and the SEC staff have focused on these questions. This Alert discusses these issues and provides guidance developed by NAREIT's Best Financial Practices Council (the Council).

SEC Staff Takes Position on FFO Treatment of Impairment Write-Downs

In recent discussions, the SEC staff has shared with NAREIT its position that impairment write-downs should not be excluded from FFO (*i.e.*, they should not be added back to GAAP Net Income in calculating FFO). This clarifies discussions earlier this year regarding the SEC staff's position with respect to compliance of NAREIT's formal definition of FFO and outstanding guidance with Item 10(e) of the Commission's non-GAAP financial reporting rule.

The revised SEC staff position describe d above is inconsistent with NAREIT's implementation guidance, issued in July 2000, which indicates that impairment write-downs of depreciable real estate should be excluded from FFO. This guidance (which was modified as of February 24, 2004) is available by clicking HERE. This guidance was issued by NAREIT in 2000 because neither the formal definition of FFO nor the FFO White Paper addresses impairment losses and they were being treated differently among member companies.

NAREIT staff discussed this issue with SEC staff, reasoning that impairment write-downs are often early recognition of losses on prospective sales of property. We further reasoned that since losses from sales are excluded from FFO, it is consistent and appropriate that write-downs in advance of the realization of losses should also be excluded. The SEC staff does not agree and has indicated that they will inform real estate companies that impairment write-downs must be included in FFO for all periods included in future filings.

The inclusion of impairment losses in the calculation of FFO is consistent with the formal definition of FFO and NAREIT's FFO White Paper.

Council concludes that Treatment of Preferred Stock Issuance Costs in Calculating FFO per Share should Follow Revised GAAP Rule

During the second quarter 2003 earnings-reporting season, a number of companies redeemed preferred stock. In the past, the treatment of original issuance costs of this stock has been inconsistent in the calculation of FFO per share in the period during which the stock has been redeemed. Some companies treated these costs in a manner similar to preferred stock

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dividends, which generally reduced FFO per share. Other companies ignored these costs in the calculation of FFO per share.

On July 29, 2003, the SEC issued a statement that these costs should be factored into the calculation of Net Income per share. This SEC view is now reflected in the Emerging Issues Task Force Issue D-42, *The Effect on the Calculation of Earnings per share for the Redemption or Induced Conversion of Preferred Stock*. Click HERE to access the revised EITF Issue D-42.

After discussing this issue, the Council concluded that the treatment of these costs should be factored into the calculation of FFO per share consistent with the guidance in EITF Issue D-42 for calculating Net Income per share. In most cases, this treatment will reduce FFO attributable to common shareholders.

Council Reminds Companies to Distinguish "FFO" and "FFO Attributable to Common Shareholders" when Reporting FFO on an Absolute Basis

In reviewing FFO reporting, the Council noted that, in some cases, companies do not appropriately label FFO reported on an absolute basis. In particular, some companies report "FFO attributable to common shareholders" but label it "FFO." NAREIT's FFO White Paper (the Paper) defines FFO without addressing per share reporting. Therefore, FFO defined in the Paper represents FFO applicable to all equity shares - not just FFO attributable to common shareholders. The Council reminds member companies that it is important to accurately distinguish and label FFO reported on an absolute basis.

Further, when reporting FFO per share, there is a presumption that the numerator is FFO attributable to common shares and, therefore, the descriptive phrase "attributable to common shareholders" is generally not included in the label. This reporting parallels Net Income and EPS reporting as mandated by FASB Statement No. 128, *Earnings Per Share*.

Any questions regarding this matter
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