Accounting for REITs: Simplifying How REITs Measure Earnings

FEBRUARY 22, 2024 | IN BLOG | BY ASSURANCE DIMENSIONS

When searching for the **right audit firm** to handle your REIT, accounting is one of the top considerations. You want to work with a firm that understands the ins and outs of REITs and can provide an audit that reflects the unique nature of these investment vehicles. But beyond just conducting an audit, it's crucial to understand how REITs measure earnings and why this measurement is essential to accounting for REITs.

In this article, we will examine these measures and what they mean for the REIT industry.

Basics for Measuring Earnings

Like the rest of corporate America, REITs use net income as defined under Generally Accepted Accounting Principles (GAAP) as the primary measure of revenue performance. On top of this, the REIT industry also relies on funds from operations (FFO) as a supplemental performance measure.

FFO is a unique feature for REITs and is defined by **NAREIT** as net income, excluding gains or losses from most property sales and real estate depreciation.

This website or its third-party tools use cookies to personalize your online experience, provide social media features, and analyze our traffic. By continuing to browse this site, you agree to the use of cookies. Accept Learn More

This website or its third-party tools use cookies to personalize your online experience, provide social media features, and analyze our traffic. By continuing to browse this site, you agree to the use of cookies. Accept Learn More

What are the benefits of FFO?

FFO can offer a more exact measure of a REIT's operating performance because it removes the effects of non-cash items, such as real estate depreciation, which may overstate or understate net income. However, GAAP is also a key component, and when real estate companies use FFO in public releases or SEC filings, they are required by law to reconcile it with GAAP net income.

Adjusted Funds from Operations (AFFO): A Closer Look

AFFO goes one step further than FFO. It considers extra expenses like the costs of extensive repairs or upgrades to properties. This can offer more transparency about a REIT's financial health and how it's managing money for investors.

Some securities analysts judge a REIT's performance based on its adjusted FFO (AFFO), which deducts certain recurring capital expenses from FFO. The importance of AFFO highlights that investors and executives must look beyond just the raw FFO figures and should consider AFFO to get a clear picture of the REIT's performance.

Tax Focus of Accounting for REITs

How a REIT calculates its earnings is incredibly relevant to the tax implications of REITs. Because REITs must distribute at least 90% of their taxable income to shareholders, those distributions must be calculated accurately and distributed carefully. As a result, REITs must reconcile their FFO and AFFO with taxable income as part of their tax planning process.

Navigating IRS Requirements in REIT Audits

While audits on REITs serve as a safeguard for investors and can provide assurance of accuracy in financial reports, they are heavily tax-focused. Compliance with stringent IRS tax regulations is at the forefront of accounting for REITs. If a REIT is out of compliance, it could face penalties and restrictions on its operating ability. That's why working with a **CPA firm** that understands and can navigate the IRS requirements is critical.

Select an Audit Firm Experienced with Accounting for REITs

Understanding how REITs measure earnings is essential for any audit firm, but it's just one piece of the puzzle. Partner with a CPA firm experienced with REIT-specific tax regulations and understand the broader implications of these rules on the REIT's operations and strategies.

We have over 75 years of combined accounting experience at Assurance Dimensions, and our **CPA auditors** perform REIT audits annually. Get in touch with us today to learn how we can help your REIT navigate tax and audit requirements.

The 3 Key GAAP Audited Financial Statements

15 Feb 2024

Preparing your company for an audit can be overwhelming, especially if you're unfamiliar with the auditing process and GAAP audited [...]

8 Feb 2024

For many business owners, the idea of conducting an independent financial statement audit causes them to cringe. Although public and [...]

Common Pitfalls to Avoid in Your 401 K Audit

1 Feb 2024

As an organization that offers retirement and 401 K plans to your employees, you realize the importance of meeting regulatory [...]

Stay in Touch

Email *

I agree to Assurance Dimensions' Privacy Policy and Terms and Conditions.*

Subscribe

© 2024 Assurance Dimensions. All rights reserved