Statement of Financial Accounting Standards No. 66

FAS66 Status Page
FAS66 Summary

Accounting for Sales of Real Estate

October 1982

Financial Accounting Standards Board
of the Financial Accounting Foundation
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CONTENTS

FAS 66: Accounting for Sales of Real Estate

FAS 66 Summary

This Statement establishes accounting standards for recognizing profit or loss on sales of real estate. It adopts the specialized profit recognition principles in the AICPA Industry Accounting Guides, *Accounting for Profit Recognition on Sales of Real Estate and Accounting for Retail Land Sales;* and AICPA Statements of Position 75-6, *Questions Concerning Profit Recognition on Sales of Real Estate,* and 78-4, *Application of the Deposit, Installment, and Cost Recovery Methods in Accounting for Sales of Real Estate.*

For retail land sales, this Statement requires that the seller's receivables from the land sales be collectible and that the seller have no significant remaining obligations for construction or development before profits are recognized by the full accrual method. Other sales in retail land sales projects are to be reported under either the percentage-of-completion or the installment method, for which the Statement establishes criteria based on the collectibility of the seller's receivables from the land sales and the seller's remaining obligations.

For other sales of real estate, this Statement provides for profit recognition by the full accrual and several other methods, depending on whether a sale has been consummated, the extent of the buyer's investment in the property being sold, whether the seller's receivable is subject to future subordination, and the degree of the seller's continuing involvement with the property after the sale. Paragraphs 3-5 set forth the general requirements for recognition of all the profit at the date of sale. Paragraphs 6-18 elaborate on those general rules. Paragraphs 19-43 provide more detailed guidance for a variety of more complicated circumstances if the criteria for immediate profit recognition are not met.

* * *

Certain provisions of this Statement that relate to accounting for sales of real estate are summarized in decision trees that appear in Appendix F.

INTRODUCTION

1. This Statement establishes standards for recognition of profit on all real estate sales transactions without regard to the nature of the seller's business. The Statement distinguishes between retail land sales and other sales of real estate because differences in terms of sales and selling procedures lead to different profit recognition criteria and methods. Accounting for real estate sales transactions that are not retail land sales is specified in paragraphs 3-43. Accounting for retail land sales transactions is specified in paragraphs 44-50. This Statement does not cover exchanges of real estate for other real estate, the accounting for which is covered in APB Opinion No. 29, *Accounting for Nonmonetary Transactions.*

2. Although this Statement applies to all sales of real estate, many of the extensive provisions were developed over several years to deal with complex transactions that are frequently encountered in enterprises that specialize in real estate transactions. The decision trees in Appendix F highlight the major provisions of the Statement and will help a user of the Statement identify criteria that determine when and how profit is recognized. Those using this Statement to determine the accounting for relatively simple real estate sales transactions will need to apply only limited portions of the Statement. The general requirements for recognizing all of the profit on a nonretail land sale at the date of sale are set forth in paragraphs 3-5 and are highlighted on the first decision tree. Paragraphs 6-18 elaborate on those general provisions. Paragraphs 19-43 provide more detailed guidance for a variety of more complex transactions. [The decision trees have been deleted in the electronic version of *Original Pronouncements*. If there is a need to reference the decision trees, please refer to the printed version of *Original Pronouncements*.]

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Real Estate Sales Other Than Retail Land Sales

Recognition of Profit by the Full Accrual Method

3. Profit shall be recognized in full when real estate is sold, provided (a) the profit is determinable, that is, the collectibility of the sales price is reasonably assured or the amount that will not be collectible can be estimated, and (b) the earnings process is virtually complete, that is, the seller is not obliged to perform significant activities after the sale to earn the profit. Unless both conditions exist, recognition of all or part of the profit shall be postponed. Recognition of all of the profit at the time of sale or at some later date when both conditions exist is referred to as the *full accrual method* in this Statement.

4. In accounting for sales of real estate, collectibility of the sales price is demonstrated by the buyer's commitment to pay, which in turn is supported by substantial initial and continuing investments that give the buyer a stake in the property sufficient that the risk of loss through default motivates the buyer to honor its obligation to the seller. Collectibility shall also be assessed by considering factors such as the credit standing of the buyer, age and location of the property, and adequacy of cash flow from the property.

5. Profit on real estate sales transactions [1] shall not be recognized by the full accrual method until all of the following criteria are met:

a. A sale is consummated (paragraph 6).
b. The buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property (paragraphs 8-16).
c. The seller's receivable is not subject to future subordination (paragraph 17).
d. The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property (paragraph 18).

Paragraphs 19-43 describe appropriate accounting if the above criteria are not met.

Consummation of a Sale

6. A sale shall not be considered consummated until (a) the parties are bound by the terms of a contract, (b) all consideration has been exchanged, (c) any permanent financing for which the seller is responsible has been arranged, and (d) all conditions [2] precedent to closing have been performed. Usually, those four conditions are met at the time of closing or after closing, not when an agreement to sell is signed or at a preclosing.

Buyer's Initial and Continuing Investment

7. "Sales value" shall be determined by:

a. Adding to the stated sales price the proceeds from the issuance of a real estate option that is exercised and other payments that are in substance additional sales proceeds. These nominally may be management fees, points, or prepaid interest or fees that are required to be maintained in an advance status and applied against the amounts due to the seller at a later date.
b. Subtracting from the sale price a discount to reduce the receivable to its present value and by the net present value of services that the seller commits to perform without compensation or by the net present value of the services in excess of the compensation that will be received. Paragraph 31 specifies appropriate accounting if services are to be provided by the seller without compensation or at less than prevailing rates.

8. Adequacy of a buyer's initial investment shall be measured by (a) its composition (paragraphs 9-10) and (b) its size compared with the sales value of the property (paragraph 11).

9. The buyer's initial investment shall include only: (a) cash paid as a down payment, (b) the buyer's notes supported by irrevocable letters of credit from an independent established lending institution,[3] (c) payments by the buyer to third parties to reduce existing indebtedness on the property, and (d) other amounts paid by the buyer that are part of the sales value. Other consideration received by the seller, including other notes of the buyer, shall be included as part of the buyer's initial investment only when that consideration is sold or otherwise converted to cash without recourse to the seller.

10. The initial investment shall not include:

a. Payments by the buyer to third parties for improvements to the property
b. A permanent loan commitment by an independent third party to replace a loan made by the seller
c. Any funds that have been or will be loaned, refunded, or directly or indirectly provided to the buyer by the seller or loans guaranteed or collateralized by the seller for the buyer [4]

11. The buyer's initial investment shall be adequate to demonstrate the buyer's commitment to pay for the property and shall indicate a reasonable likelihood that the seller will collect the receivable. Lending practices of independent established lending institutions provide a reasonable basis for assessing the collectibility of receivables from buyers of real estate. Therefore, to qualify, the initial investment shall be equal to at least a major part of the difference between usual loan limits and the sales value of the property. Guidance on minimum initial investments in various types of real estate is provided in paragraphs 53 and 54.

12. The buyer's continuing investment in a real estate transaction shall not qualify unless the buyer is contractually required to pay each year on its total debt for the purchase price of the property an amount at least equal to the level annual payment that would be needed to pay that debt and interest on the unpaid balance over no more than (a) 20 years for debt for land and (b) the customary amortization term of a first mortgage loan by an independent established lending institution for other real estate. For this purpose, contractually required payments by the buyer on its debt shall be in the forms specified in paragraph 9 as acceptable for an initial investment. Except as indicated in the following sentence, funds to be provided directly or indirectly by the seller (paragraph 10(c)) shall be subtracted from the buyer's contractually required payments in determining whether the initial and continuing investments are adequate. If a future loan on normal terms from an established lending institution bears a fair market interest rate and the proceeds of the loan are conditional on use for specified development of or construction on the property, the loan need not be subtracted in determining the buyer's investment.

Release Provisions

13. An agreement to sell property (usually land) may provide that part or all of the property may be released from liens securing related debt by payment of a release price or that payments by the buyer may be assigned first to released property. If either of those conditions is present, a buyer's initial investment shall be sufficient both to pay release prices on property released at the date of sale and to constitute an adequate initial investment on property not released or not subject to release at that time in order to meet the criterion of an adequate initial investment for the property as a whole.

14. If the release conditions described in paragraph 13 are present, the buyer's investment shall be sufficient, after the released property is paid for, to constitute an adequate continuing investment on property not released in order to meet the criterion of an adequate continuing investment for the property as a whole (paragraph 12).

15. If the amounts applied to unreleased portions do not meet the initial and continuing-investment criteria as applied to the sales value of those unreleased portions, profit shall be recognized on each released portion when it meets the criteria in paragraph 5 as if each release were a separate sale.

16. Tests of adequacy of a buyer's initial and continuing investments described in paragraphs 8-15 shall be applied cumulatively when the sale is consummated and annually afterward. If the initial investment exceeds the minimum prescribed, the excess shall be applied toward the required annual increases in the buyer's investment.

Future Subordination

17. The seller's receivable shall not be subject to future subordination. This restriction shall not apply if (a) a receivable is subordinate to a first mortgage on the property existing at the time of sale or (b) a future loan, including an existing permanent loan commitment, is provided for by the terms of the sale and the proceeds of the loan will be applied first to the payment of the seller's receivable.

Continuing Involvement without Transfer of Risks and Rewards

18. If a seller is involved with a property after it is sold in any way that results in retention of substantial risks or rewards of ownership, except as indicated in paragraph 43, the absence-of-continuing-involvement criterion has not been met. Forms of involvement that result in retention of substantial risks or rewards by the seller, and accounting therefore, are described in paragraphs 25-42.

Recognition of Profit When the Full Accrual Method Is Not Appropriate

19. If a real estate sales transaction does not satisfy the criteria in paragraphs 3-18 for recognition of profit by the full accrual method, the transaction shall be accounted for as specified in the following paragraphs.

Sale Not Consummated

20. The deposit method of accounting described in paragraphs 65-67 shall be used until a sale has been consummated (paragraph 6). "Consummation" usually requires that all conditions precedent to closing have been performed, including that the building be certified for occupancy. However, because of the length of the construction period of office buildings, apartments, condominiums, shopping centers, and similar structures, such sales and the related income may be recognized during the process of construction, subject to the criteria in paragraphs 41 and 42, even though a certificate of occupancy, which is a condition precedent to closing, has not been obtained.

21. If the net carrying amount of the property exceeds the sum of the deposit received, the fair value of the unrecorded note receivable, and the debt assumed by the buyer, the seller shall recognize the loss at the date the agreement to sell is signed.[5] If a buyer defaults, or if circumstances after the transaction indicate that it is probable the buyer will default and the property will revert to the seller, the seller shall evaluate whether the circumstances indicate a decline in the value of the property for which an allowance for loss should be provided.

Initial or Continuing Investments Do Not Qualify

22. If the buyer's initial investment does not meet the criteria specified in paragraphs 8-11 for recognition of profit by the full accrual method and if recovery of the cost of the property is reasonably assured if the buyer defaults, the installment method described in paragraphs 56-61 shall be used. If recovery of the cost of the property is not reasonably assured if the buyer defaults or if cost has already been recovered and collection of additional amounts is uncertain, the cost recovery method (described in paragraphs 62-64) or the deposit method (described in paragraphs 65-67) shall be used. The cost recovery method may be used to account for sales of real estate for which the installment method would be appropriate.

23. If the initial investment meets the criteria in paragraphs 8-11 but the continuing investment by the buyer does *not* meet the criteria in paragraphs 12 and 16, the seller shall recognize profit by the reduced profit method described in paragraphs 68 and 69 at the time of sale if payments by the buyer each year will at least cover both of the following:

a. The interest and principal amortization on the maximum first mortgage loan that could be obtained on the property
b. Interest, at an appropriate rate,[6] on the excess of the aggregate actual debt on the property

over such a maximum first mortgage loan

If the criteria specified in this paragraph for use of the reduced profit method are not met, the seller may recognize profit by the installment method (paragraphs 56-61) or the cost recovery method (paragraphs 62-64).

Receivable Subject to Future Subordination

24. If the seller's receivable is subject to future subordination as described in paragraph 17, profit shall be recognized by the cost recovery method (paragraphs 62-64).

Continuing Involvement without Transfer of Risks and Rewards

25. If the seller has some continuing involvement with the property and does not transfer substantially all of the risks and rewards of ownership, profit shall be recognized by a method determined by the nature and extent of the seller's continuing involvement. Generally, profit shall be recognized at the time of sale if the amount of the seller's loss of profit because of continued involvement with the property is limited by the terms of the sales contract. The profit recognized shall be reduced by the maximum exposure to loss. Paragraphs 26-43 describe some common forms of continuing involvement and specify appropriate accounting if those forms of involvement are present. If the seller has some other form of continuing involvement with the property, the transaction shall be accounted for according to the nature of the involvement.

26. *The seller has an obligation to repurchase the property, or the terms of the transaction allow the buyer to compel the seller or give an option* [7] *to the seller to repurchase the property.* The transaction shall be accounted for as a financing, leasing, or profit-sharing arrangement rather than as a sale.

27. *The seller is a general partner in a limited partnership that acquires an interest in the property sold (or has an extended, noncancelable management contract requiring similar obligations) and holds a receivable from the buyer for a significant* [8] *part of the sales price.* The transaction shall be accounted for as a financing, leasing, or profit-sharing arrangement.

28. *The seller guarantees* [9] *the return of the buyer's investment or a return on that investment for a limited or extended period.* For example, the seller guarantees cash flows, subsidies, or net tax benefits. If the seller guarantees return of the buyer's investment or if the seller guarantees a return on the investment for an extended period, the transaction shall be accounted for as a financing, leasing, or profit-sharing arrangement. If the guarantee of a return on the investment is for a limited period, the deposit method shall be used until operations of the property cover all operating expenses, debt service, and contractual payments. At that time, profit shall be recognized on the basis of performance of the services required, as illustrated in paragraphs 84-88.

29. *The seller is required to initiate or support operations or continue to operate the property at its own risk, or may be presumed to have such a risk, for an extended period, for a specified limited period, or until a specified level of operations has been obtained, for example, until rentals of a property are sufficient to cover operating expenses and debt service.* If support is required or presumed to be required [10] for an *extended* period of time, the transaction shall be accounted for as a financing, leasing, or profit-sharing arrangement. If support is required or presumed to be required for a *limited* time, profit on the sale shall be recognized on the basis of performance of the services required. Performance of those services shall be measured by the costs incurred and to be incurred over the period during which the services are performed. Profit shall begin to be recognized when there is reasonable assurance that future rent receipts will cover operating expenses and debt service including payments due the seller under the terms of the transaction. Reasonable assurance that rentals will be adequate would be indicated by objective information regarding occupancy levels and rental rates in the immediate area. In assessing whether rentals will be adequate to justify recognition of profit, total estimated future rent receipts of the property shall be reduced by one-third as a reasonable safety factor unless the amount so computed is less than the rents to be received from signed leases. In this event, the rents from signed leases shall be substituted for the computed amount. Application of this method is illustrated in paragraphs 84-89.

30. If the sales contract does not stipulate the period during which the seller is obligated to support operations of the property, support shall be presumed for at least two years from the time of initial rental unless actual rental operations cover operating expenses, debt service, and other contractual commitments before that time. If the seller is contractually obligated for a longer time, profit recognition shall continue on the basis of performance until the obligation expires. Calculation of profits on the basis of performance of services is illustrated in paragraphs 84-89.

31. If the sales contract requires the seller to provide management services relating to the property after the sale without compensation or at compensation less than prevailing rates for the service required (paragraph 7) or on terms not usual for the services to be rendered (footnote 10(d)), compensation shall be imputed when the sale is recognized and shall be recognized in income as the services are performed over the term of the management contract.

32. *The transaction is merely an option to purchase the property.* For example, undeveloped land may be "sold" under terms that call for a very small initial investment by the buyer (substantially less than the percentages specified in paragraph 54) and postponement of additional payments until the buyer obtains zoning changes or building permits or other contingencies specified in the sales agreement are satisfactorily resolved. Proceeds from the issuance of the option by a property owner shall be accounted for as a deposit (paragraphs 65-67). Profit shall not be recognized until the option either expires or is exercised. When an option to purchase real estate is sold by an option holder,[11] the seller of the option shall recognize income by the cost recovery method (paragraphs 62-64) to the extent nonrefundable cash proceeds exceed the seller's cost of the option if the buyer's initial and continuing investments are not adequate for profit recognition by the full accrual method (paragraphs 7-16).

33. *The seller has made a partial sale.* A sale is a partial sale if the seller retains an equity interest in the property or has an equity interest in the buyer. Profit (the difference between the sales value and the proportionate cost of the partial interest sold) shall be recognized at the date of sale if:

a. The buyer is independent of the seller.
b. Collection of the sales price is reasonably assured (paragraph 4).
c. The seller will not be required to support the operations of the property or its related obligations to an extent greater than its proportionate interest.

34. If the buyer is not independent of the seller, for example, if the seller holds or acquires an equity interest in the buyer, the seller shall recognize the part of the profit proportionate to the outside interests in the buyer at the date of sale. If the seller controls the buyer, no profit on the sale shall be recognized until it is realized from transactions with outside parties through sale or operations of the property.

35. If collection of the sales price is not reasonably assured, the cost recovery or installment method of recognizing profit shall be used.

36. If the seller is required to support the operations of the property after the sale, the accounting shall be based on the nature of the support obligation. For example, the seller may retain an interest in the property sold and the buyer may receive preferences as to profits, cash flows, return on investment, and so forth. If the transaction is in substance a sale, the seller shall recognize profit to the extent that proceeds from the sale, including receivables from the buyer, exceed all of the seller's costs related to the entire property. Other examples of support obligations are described in paragraphs 29-31.

37. If individual units in condominium projects [12] or time-sharing interests are being sold separately and all the following criteria are met, profit shall be recognized by the percentage-of-completion method on the sale of individual units or interests:

a. Construction is beyond a preliminary stage.[13]
b. The buyer is committed to the extent of being unable to require a refund except for nondelivery of the unit or interest.[14]
c. Sufficient units have already been sold to assure that the entire property will not revert to rental property. In determining whether this condition has been met, the seller shall consider the requirements of state laws, the condominium or time-sharing contract, and the terms of the financing agreements.
d. Sales prices are collectible (paragraph 4).
e. Aggregate sales proceeds and costs can be reasonably estimated. Consideration shall be given to sales volume, trends of unit prices, demand for the units including seasonal factors, developer's experience, geographical location, and environmental factors.

If any of the above criteria is not met, proceeds shall be accounted for as deposits until the criteria are met.

38. *The seller sells property improvements and leases the underlying land to the buyer of the improvements.* In these circumstances, the transactions are interdependent and it is impracticable to distinguish between profits on the sale of the improvements and profits under the related lease. The transaction shall be accounted for as a lease of both the land and improvements if the term of the land lease to the buyer from the seller of the improvements either (a) does not cover substantially all of the economic life of the property improvements, thus strongly implying that the transaction is in substance a lease of both land and improvements, or (b) is not for a substantial period, for example, 20 years.

39. If the land lease described in paragraph 38 covers substantially all of the economic life of the improvements and extends for at least 20 years, the profit to be recognized on the sale of the improvements at the time of sale shall be (a) the present value of the rental payments [15] not in excess of the seller's cost of the land plus (b) the sales value of the improvements minus (c) the carrying value of the improvements and the land. Profit on (1) the buyer's rental payments on the land in excess of the seller's cost of the land and (2) the rent to be received on the land after the maturity of the primary indebtedness on the improvements or other customary amortization term shall be recognized when the land is sold or the rents in excess of the seller's cost of the land are accrued under the lease. Calculations of profit in those circumstances are illustrated in paragraphs 82 and 83.

40. *The sale of the property is accompanied by a leaseback to the seller of all or any part of the property for all or part of its remaining economic life.* Real estate sale and leaseback transactions shall be accounted for in accordance with the provisions of this Statement and FASB Statements No. 13, *Accounting for Leases,* and 28, *Accounting for Sales with Leasebacks.* Statement 13 as amended by Statement 28 provides criteria for determining if a leaseback is a capital lease or an operating lease. If the leaseback is a capital lease, the seller-lessee shall record an asset and an obligation as prescribed by Statement 13. Regardless of whether the leaseback is a capital lease or an operating lease, a sale shall be recorded, and the property sold and any related debt assumed by the buyer shall be removed from the seller-lessee's balance sheet. The criteria in this Statement then shall be used to determine the amount of profit that would be recognized at the date of sale, absent the leaseback provisions. The profit so determined shall be accounted for in accordance with the provisions of Statements 13 and 28 (usually deferred and amortized over the term of the lease) unless other provisions of this Statement require postponement of profit recognition until a later event.

41. *The sales contract or an accompanying agreement requires the seller to develop the property in the future, to construct facilities on the land, or to provide off-site improvements or amenities.* The seller is involved with future development or construction work if the buyer is unable to pay amounts due for that work or has the right under the terms of the arrangement to

defer payment until the work is done. If future costs of development can be reasonably estimated at the time of sale, profit allocable to (a) performance before the sale of the land and (b) the sale of the land shall be recognized when the sale of the land meets the criteria in paragraph 5. Profit allocable to performance after the sale shall be recognized by the percentage-of-completion method as development and construction proceed, provided that cost and profit can be reasonably estimated from the seller's previous experience.

42. The profit shall be allocated to the sale of the land and the later development or construction work on the basis of estimated costs of each activity; the same rate of profit shall be attributed to each activity. No profit shall be recognized at the time of sale if future costs of development cannot be reasonably estimated at that time.

43. *The seller will participate in future profit from the property without risk of loss (such as participation in operating profits or residual values without further obligation).* If the transaction otherwise qualifies for recognition of profit by the full accrual method, the transfer of risks and rewards of ownership and absence of continuing involvement criterion shall be considered met. The contingent future profits shall be recognized when they are realized.[16] All the costs of the sale shall be recognized at the time of sale; none shall be deferred to periods when the contingent profits are recognized.

Retail Land Sales

44. A single method of recognizing profit shall be applied to all sales transactions within a project [17] that have been consummated.[18] That method of recognizing profit shall be changed when certain conditions are met for the entire project (paragraph 49).

Recognition of Profit

45. The full accrual method of accounting described in paragraphs 70-72 shall be applied to a sale if all of the following conditions are met:

a. *Expiration of refund period.* The buyer has made the down payment and each required subsequent payment until the period of cancellation with refund has expired. That period shall be the longest period of those required by local law, established by the seller's policy, or specified in the contract.
b. *Sufficient cumulative payments.* The cumulative payments of principal and interest equal or exceed 10 percent of the contract sales price.
c. *Collectibility of receivables.* Collection experience for the project in which the sale is made or for the seller's prior projects indicates that at least 90 percent of the contracts in the project in which the sale is made that are in force 6 months after the criteria in paragraph 46 are met will be collected in full.[19] The collection experience with the seller's prior projects may be applied to a new project if the prior projects:
   (1) Had predominantly the same characteristics (type of land, environment,

clientele, contract terms, sales methods) [20] as the new project.

(2) Had a sufficiently long collection period to indicate the percentage of current sales of the new project that will be collected to maturity.

A down payment of at least 20 percent shall be an acceptable indication of collectibility.

d. *Nonsubordination of receivables.* The receivable from the sale is not subject to subordination to new loans on the property except that subordination by an individual lot buyer for home construction purposes is permissible if the collection experience on those contracts is the same as on contracts not subordinated.

e. *Completion of development.* The seller is not obligated to complete improvements of lots sold or to construct amenities or other facilities applicable to lots sold.

Paragraphs 46-49 specify accounting methods that shall be used if the above criteria are not met.

46. The percentage-of-completion method of accounting [21] described in paragraphs 73-75 shall be applied to a sale that meets all of the following criteria:

a. *The period of cancellation with refund has expired* (paragraph 45(a)).
b. *Cumulative payments equal or exceed 10 percent* (paragraph 45(b)).
c. *Receivables are collectible* (paragraph 45(c).
d. *Receivables are not subject to subordination* (paragraph 45(d)).
e. *There has been progress on improvements.* The project's improvements have progressed beyond preliminary stages, and there are indications that the work will be completed according to plan. Some indications of progress are:
   (1) The expenditure of funds on the proposed improvements.
   (2) Initiation of work on the improvements.
   (3) Existence of engineering plans and work commitments relating to lots sold.
   (4) Completion of access roads and amenities such as golf courses, clubs, and swimming pools.

   In addition, there shall be no indication of significant delaying factors, such as the inability to obtain permits, contractors, personnel, or equipment, and estimates of costs to complete and extent of progress toward completion shall be reasonably dependable.
f. *Development is practical.* There is a reasonable expectation that the land can be developed for the purposes represented and the properties will be useful for those purposes at the end of the normal payment period. For example, it should be expected that legal restrictions, including environmental restrictions, will not seriously hamper development and that improvements such as access roads, water supply, and sewage treatment or removal are feasible within a reasonable time.

Paragraphs 47 and 48 specify accounting methods that shall be used if the above criteria are not met.

47. The installment method of accounting described in paragraphs 56-61 shall be applied to a sale that meets all of the following criteria:

a. *The period of cancellation with refund has expired* (paragraph 45(a)).
b. *Cumulative payments equal or exceed 10 percent* (paragraph 45(b)).
c. *The seller is financially capable.* The seller is clearly capable of providing both land improvements and off-site facilities promised in the contract and of meeting all other representations it has made. It is financially capable of funding or bonding the planned improvements in the project when required. That capability may be indicated by the seller's equity capitalization, its borrowing capacity, or its positive cash flow from operations.

48. If a retail land sale transaction does not meet the criteria for accounting by the methods described in paragraphs 45-47, that transaction shall be accounted for as a deposit as described in paragraphs 65-67.

Change from Installment to Percentage-of-Completion Method

49. When all of the conditions in paragraph 46 are satisfied on a retail land sales project originally reported by the installment method, the percentage-of-completion method of accounting may be adopted for the entire project (current and prior sales) and the effect accounted for as a change in accounting estimate.[22]

Financial Statement Presentation and Disclosures

50. In addition to disclosures otherwise required by generally accepted accounting principles, the financial statements of enterprises with retail land sales operations shall disclose:

a. Maturities of accounts receivable for each of the five years following the date of the financial statements
b. Delinquent accounts receivable and the method(s) for determining delinquency
c. The weighted average and range of stated interest rates of receivables
d. Estimated total costs and estimated dates of expenditures for improvements for major areas from which sales are being made over each of the five years following the date of the financial statements
e. Recorded obligations for improvements

Financial statement presentations of retail land sales transactions are illustrated in paragraphs 95-97.

Amendments to Other Pronouncements

51. The references to the AICPA Industry Accounting Guides, *Accounting for Profit Recognition on Sales of Real Estate and Accounting for Retail Land Sales,* and the AICPA Statements of Position (SOPs) 75-6, *Questions Concerning Profit Recognition on Sales of Real Estate and 78-4, Application of the Deposit, Installment, and Cost Recovery Methods in Accounting for Sales of Real Estate,* are deleted from Appendix A of FASB Statement No. 32,

Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters. The references to the profit recognition Guide in paragraph 7 of FASB Statement No. 26, *Profit Recognition on Sales-Type Leases of Real Estate,* and in footnote "*" and paragraphs 23-25 of Statement 28 are amended to refer to Statement No. 66, *Accounting for Sales of Real Estate.*

Effective Date and Transition

52. This Statement shall be applied to real estate sales transactions entered into after December 31, 1982 and to changes in methods of accounting for real estate sales transactions made after that date. Earlier application is encouraged but not required. The disclosures required by paragraph 50 shall be provided in financial statements for periods ending after December 15, 1982.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Morgan and Walters dissented.

Mr. Morgan dissents to the issuance of this Statement. Although he recognizes the Board's commitment to extract specialized principles and practices from SOPs and Guides and to issue them as FASB Statements, as stated in paragraph 2 of Statement 32, and the fact that issuance of this Statement is considered by a majority of Board members to be a fulfillment of part of that commitment, Mr. Morgan believes this Statement should be deferred until certain other projects are completed.

Incorporation of these detailed guidelines into accounting standards is inappropriate at this time in view of three projects in process that should bear on the nature and effect of accounting standards in this area:

a. The Board's conceptual framework project on accounting recognition, which should establish a basic framework for all revenue recognition
b. The Board's project on financial reporting by private and small public companies
c. The August 1982 report of the Financial Accounting Foundation's Structure Committee, which acknowledges the comments of many respondents that the Board should deal primarily with broad accounting standards issues and charges the Board to develop a plan, for consideration by the Trustees, to provide timely *guidance* for implementation questions and emerging issues

Mr. Morgan believes that no urgent need for an FASB Statement on this subject has been demonstrated. Accordingly, he believes it more prudent to complete the broader, more general projects before further considering whether this Statement is needed.

Mr. Walters dissents to the issuance of this Statement primarily because he objects to incorporating these complex, rigid, and detailed rules into accounting standards. Entirely aside from the conceptual merit of these rules, which is at least debatable, he believes the Board should focus at about the level expressed in paragraphs 3 and 4 of this Statement. Beyond that, he believes the accounting profession can serve its members by offering more specific *guidance* for applying the standards in particular specialized areas, but such detailed and arbitrary guidelines should not be dignified as accounting standards. To do so debases accounting standards and inevitably will diminish the stature and effectiveness of the accounting profession, whose strength and purpose arise from applying broad accounting and reporting objectives and standards to specific circumstances with professional judgment and objectivity. That judgment is the hallmark of a true profession.

Secondarily, he believes that incorporation of these detailed guidelines into accounting standards is particularly inappropriate at this time for the reasons cited by Mr. Morgan.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: MINIMUM INITIAL INVESTMENTS

53. Minimum initial investment requirements for sales, other than retail land sales, that are to be accounted for by the full accrual method are specified in paragraph 11. The table of minimum initial investments in paragraph 54 is based on usual loan limits for various types of properties. However, lenders' appraisals of specific properties may differ. Therefore, if a recently placed permanent loan or firm permanent loan commitment for maximum financing of the property exists with an independent established lending institution, the minimum initial investment should be whichever of the following is greater:

a. The minimum percentage of the sales value (paragraph 7) of the property specified in paragraph 54
b. The lesser of:
   (1) The amount of the sales value of the property in excess of 115 percent of the amount of a newly placed permanent loan or firm permanent loan commitment from a primary lender that is an independent established lending institution
   (2) Twenty-five percent of the sales value

54. This table does not cover every type of real estate property. To evaluate initial investments on other types of property, enterprises may make analogies to the types of properties specified, or the risks of a particular property can be related to the risks of the properties specified. Use of this table is illustrated in paragraphs 77-83.

	Minimum Initial Investment Expressed as a Percentage of Sales Value
Land	
Held for commercial, industrial, or residential development to commence within two years after sale	20
Held for commercial, industrial, or residential development to commence after two years	25
Commercial and Industrial Property	
Office and industrial buildings, shopping centers, and so forth:	
Properties subject to lease on a long-term lease basis to parties with satisfactory credit rating; cash flow currently sufficient to service all indebtedness	10
Single-tenancy properties sold to a buyer with a satisfactory credit rating	15
All other	20
Other income-producing properties (hotels, motels, marinas, mobile home parks, and so forth):	
Cash flow currently sufficient to service all indebtedness	15
Start-up situations or current deficiencies in cash flow	25
Multifamily Residential Property	
Primary residence:	
Cash flow currently sufficient to service all indebtedness	10
Start-up situations or current deficiencies in cash flow	15
Secondary or recreational residence:	
Cash flow currently sufficient to service all indebtedness	15
Start-up situations or current deficiencies in cash flow	25
Single-Family Residential Property (including condominium or cooperative housing)	
Primary residence of the buyer	5[a]
Secondary or recreational residence	10[a]

Appendix B: DESCRIPTION OF CERTAIN METHODS OF ACCOUNTING FOR REAL ESTATE SALES TRANSACTIONS

55. This appendix describes several of the methods of profit recognition that are provided for by this Statement.

Installment Method

56. The installment method apportions each cash receipt and principal payment by the buyer on debt assumed between cost recovered and profit. The apportionment is in the same ratio as total cost and total profit bear to the sales value. The calculation is illustrated in paragraph 90.

57. If the stated interest rate is equal to or less than an appropriate interest rate, it is acceptable not to reduce the receivable to its present value. This ordinarily results in reducing profit recognized in the earlier years.

58. Under the installment method, the receivable less profits not recognized does not exceed what the property value would have been if the property had not been sold.

59. The income statement, or related footnotes, for the period including the date of sale presents the sales value, the gross profit that has not yet been recognized, and the total cost of the sale. Revenue and cost of sales (or gross profit) are presented as separate items on the income statement or are disclosed in the footnotes when profit is recognized as earned. This presentation is illustrated in paragraph 96.

60. Paragraph 75 describes accounting for obligations for future improvement costs under the percentage-of-completion method. That description applies as well to accounting for those obligations under the installment method.

61. If after adoption of the installment method the transaction meets the requirements for the full accrual method (specified in paragraphs 3-18) of recognizing profit for real estate sales other than retail land sales, the seller may then change to the full accrual method. The remaining profit that was not recognized is recognized in income at that time.

Cost Recovery Method

62. Under the cost recovery method, no profit is recognized until cash payments by the buyer, including principal and interest on debt due to the seller and on existing debt assumed by the buyer, exceed the seller's cost of the property sold.[23] The receivable less profits not recognized, if any, does not exceed what the depreciated property value would have been if the property had not been sold.

63. The income statement for the period including the date of sale presents the sales value, the gross profit that has not yet been recognized, and the total cost of the sale. Gross profit not yet recognized is offset against the related receivable on the balance sheet. Principal collections reduce the related receivable, and interest collections on such receivables increase the unrecognized gross profit on the balance sheet. Gross profit is presented as a separate item of revenue on the income statement when it is recognized as earned.

64. If, after the adoption of the cost recovery method, the transaction meets the requirements for the full accrual method (specified in paragraphs 3-18), the seller may then change to the full accrual method. The remaining profit that was not recognized is recognized in income at that time.

Deposit Method

65. Under the deposit method, the seller does not recognize any profit, does not record notes receivable, continues to report in its financial statements the property and the related existing debt even if it has been assumed by the buyer, and discloses that those items are subject to a sales contract. The seller continues to charge depreciation to expense as a period cost for the property for which deposits have been received. Cash received from the buyer, including the initial investment and subsequent collections of principal and interest, is reported as a deposit on the contract except that, for sales that are not retail land sales, portions of cash received that are designated by the contract as interest and are not subject to refund offset carrying charges (property taxes and interest on existing debt) on the property. Interest collected that is subject to refund and is included in the deposit account before a sale is consummated is accounted for as part of the buyer's initial investment (paragraph 7) at the time the sale is consummated.

66. When a contract is canceled without a refund, deposits forfeited are recognized as income. When deposits on retail land sales are ultimately recognized as sales, the interest portion is recognized as interest income.

67. The seller's balance sheet presents nonrecourse debt assumed by the buyer among the liabilities; the debt assumed is not offset against the related property. The seller reports the buyer's principal payments on mortgage debt assumed as additional deposits with corresponding reductions of the carrying amount of the mortgage debt.

Reduced-Profit Method

68. A reduced profit is determined by discounting the receivable from the buyer to the present value of the lowest level of annual payments required by the sales contract over the maximum period specified in paragraph 12 and excluding requirements to pay lump sums. The present value is calculated using an appropriate interest rate,[24] but not less than the rate stated in the sales contract. This method permits profit to be recognized from level payments on the buyer's

debt over the maximum term established in paragraph 12 and postpones recognition of other profits until lump sum or other payments are made.

69. To illustrate, assume a sale of land that cost the seller $800,000 and is being sold for $1,000,000 with the following financing:

Buyer's initial investment	$ 250,000
First mortgage note payable to an independent lending institution (Terms—15 percent interest payable annually over 20 years: $79,881 per year including principal and interest)	500,000
Second mortgage note payable to seller (Terms—12 percent interest payable annually over 25 years: $31,875 per year including principal and interest)	250,000
Total selling price	$1,000,000

The amortization term of the second mortgage (25 years) exceeds the term permitted by paragraph 12 (20 years for sales of land). It is assumed that the payments by the buyer each year will meet the requirement in paragraph 23, that the reduced-profit method is to be applied, and that the market interest rate is 16 percent.

The present value of $31,875 per year for 20 years at a market rate of 16 percent is $31,875 x 5.92884 = $188,982.

The profit to be recognized at the time of sale is reduced by the difference between the face amount of the seller's receivable ($250,000) and the reduced amount ($188,982), or $61,018. The profit recognized at the time of sale is $1,000,000 (sales price) minus $800,000 (cost) minus $61,018, or $138,982. Additional profit of $61,018 is recognized as the second mortgage payments are received in years 21 through 25.

Full Accrual Method—Retail Land Sales

70. Revenues and costs are accounted for under the accrual method as follows:

a. The net receivable is discounted to the present value of the payments required. The present value is determined using an appropriate interest rate,[25] not less than the rate stated in the sales contract. The objective is to value the net receivable at the amount at which it could be sold without recourse to the seller at the date of the sales contract.
b. An allowance is provided for receivables that are not expected to be collected because of cancellation in subsequent periods. Receivable balances applicable to canceled contracts are charged in their entirety to the allowance for contract cancellations when those contracts are canceled.
c. Costs of sales (land and improvement costs incurred, carrying costs, and so forth) are based

on sales net of those sales expected to be canceled in future periods.

71. Historical data is evaluated to predict the collection of receivables from current sales. The historical data is selected from a representative sample of receivables that reflect the latest available collection data and cover an adequate period of time. The receivables in the sample are considered uncollectible and the allowance for contract cancellations provided for previously recognized sales (paragraph 70(b)) is appropriately adjusted if payments due are unpaid at the end of the sample period selected for the following delinquency periods:

Percent of Contract Price Paid	Delinquency Period
Less than 25 percent	90 days
25 percent but less than 50 percent	120 days
50 percent and over	150 days

The specified delinquency periods may be extended if the seller's recent experience has been better or if the buyer has accepted, or is willing to accept, personal liability on its debt, provided that the buyer's ability to complete payment on the contract can be determined.

72. Many sellers have programs to accelerate collections of receivables or contract provisions that encourage prepayment with a reduction of the principal as the major incentive for prepayment. If a seller expects to institute those or similar programs in the future, the amount of profit recognized at the date of sale is reduced through charges to income for anticipated discounts not otherwise recognized. Reductions that are given sporadically are charged to income in the period they occur.

Percentage-of-Completion Method—Retail Land Sales

73. The earnings process is not complete if a seller is obliged to complete improvements of lots sold or to construct amenities and other facilities applicable to lots sold, if those obligations are significant in relation to total costs, and if they remain unperformed at the time the sale is recognized. Therefore, the amount of revenue recognized (the discounted contract price) at the time a sale is recognized is measured by the relationship of costs already incurred to total estimated costs to be incurred, including costs of the marketing effort. If performance [26] is incomplete, the portion of revenue related to costs not yet incurred is recognized as the costs are incurred.

74. The costs already incurred and total costs to be incurred include land cost, costs previously charged to expense, such as interest and project carrying costs incurred prior to sale, and selling costs [27] directly associated with a project. The accounting described in this paragraph and paragraph 73 is illustrated in paragraphs 91-95.

75. If there is an obligation for future improvement costs that is recognized under the percentage-of-completion method:

a. Estimates are based on costs generally expected in the construction industry locally.
b. Unrecoverable costs of off-site improvements, utilities, and amenities are provided for. In determining the amount of unrecoverable costs, estimates of amounts to be recovered from future sale of the improvements, utilities, and amenities are discounted to present value as of the date the net unrecoverable costs are recognized.

76. Estimates of future improvement costs are reviewed at least annually. Changes in those estimates do not lead to adjustment of revenue applicable to future improvements that has been previously recorded unless the adjusted total estimated cost exceeds the applicable revenue. When cost estimates are revised, the relationship of the two elements included in the revenue not yet recognized—costs and profit—is recalculated on a cumulative basis to determine future income recognition as performance takes place. If the adjusted total estimated cost exceeds the applicable revenue previously recognized, the total anticipated loss is charged to income when it meets the criteria in paragraph 8 of Statement 5. When anticipated losses on lots sold are recognized, the enterprise also considers recognizing a loss on land and improvements not yet sold.

Appendix C: ILLUSTRATIONS OF CALCULATIONS FOR RECOGNITION OF PROFIT ON SALES OF REAL ESTATE OTHER THAN RETAIL LAND SALES [28]

Exhibits

Exhibit I—Illustration of Effect of Land Lease—New Multifamily Residential Property

77. Land improvements may be sold and concurrently the land under the improvements may be leased to the buyer of the improvements.

78. This exhibit illustrates the effect of loans issued in connection with long-term land leases on evaluations of the adequacy of a buyer's initial investment if improvements on the land are sold separately. In addition, it demonstrates the limit that a lease places on profit recognition if the leased land is owned by the seller of the improvements, making the lease of land and sale of improvements interdependent transactions.

79. The calculations are illustrated for four different circumstances: two examples with a primary land lease and two with a subordinated land lease.

80. Primary Land Lease: Land Owned by Third Party Lessor—Nonqualifying

Assumptions:	
Sales price of improvements	$ 875,000
Represented by proceeds of:	
Cash down payment	$ 125,000
Loan by insurance company—lien on leasehold improvements, 28-year term, 8 1/2%, payable in equal monthly installments of principal and interest	657,000
Note received by seller from buyer: 12-year term, 9 1/2%, payable in equal monthly installments of principal and interest	93,000
	$ 875,000

Land lease for 99 years @ $19,000/year, net, payable monthly in advance
Cost of constructing improvements—$750,000
No continuing involvement by seller

Computations:	
Present value of 336 monthly payments on land lease of $1,583.33 discounted at 8 1/2% (interest rate on loan from insurance company): $1,583.33 + ($1,583.33 × 127.9071)	$ 204,000
Loan from insurance company	657,000
Equivalent primary debt	861,000
Note receivable from buyer	93,000
Total debt or equivalent	954,000
Down payment	125,000
Sales value	$1,079,000

Because 15% of the sales value of the improvements is $161,850, the initial investment of $125,000 (about 12% of adjusted sales value) is inadequate to recognize profit on the sale of improvements. The second test is therefore irrelevant.

81. Primary Land Lease: Land Owned by Third Party Lessor–Qualifying

Assumptions:

Sales price of improvements	$ 875,000
Represented by proceeds of:	
Cash down payment	$ 165,000
Loan by insurance company: lien on leasehold improvements, 28-year term, 8 1/2%, payable in equal monthly installments of principal and interest	657,000
Note received by seller from buyer: 12-year term, 9 1/2%, payable in equal monthly installments of principal and interest	53,000
	$ 875,000

Land lease for 99 years @ $17,880/year, net, payable monthly in advance
Cost of constructing improvements-–$750,000
No continuing involvement by seller

Computations:

Present value of 336 monthly payments on land lease of $1,490 discounted at 8 1/2% (interest rate on loan from insurance company): $1,490 + ($1,490 × 127.9071)	$ 192,000
Loan from insurance company	657,000
Equivalent primary debt	849,000
Note receivable from buyer	53,000
Total debt or equivalent	902,000
Down payment	165,000
Sales value	$1,067,000

Because 15% of the sales value of the improvements is $160,050, the initial investment of $165,000 (15% of the sales value) is adequate to recognize profit on the sale of improvements. However, the second test must also be applied.

The initial investment required by the second test is:

Sales value	$1,067,000
115% of $849,000 (loan from primary lender)	976,350
	$ 90,650

The initial investment of $165,000 exceeds the amount required, so recognition of profit on sale of improvements is appropriate. The second test may alternatively be applied as the ratio of total debt or equivalent to the equivalent primary debt: $902,000/$849,000 = 106%. Because 106% is less than 115%, the initial investment exceeds the difference between the sales value of the property and 115% of the equivalent primary debt.

Profit recognition:

Sales price of improvements	$ 875,000
Less: Cost of improvements	750,000
Profit recognized at time of sale	$ 125,000

82. Subordinated Land Lease: Land Owned by Seller—Qualifying

Assumptions:

Sales price of improvements	$ 914,000
Represented by proceeds of:	
Cash down payment	$ 154,000
Loan by insurance company: first lien on the fee or on subordinated leasehold, 28-year term, 8 1/4%, payable in equal monthly installments of principal and interest	760,000
	$ 914,000

Land lease for 99 years @ $11,580/year, net, payable monthly in advance, and 5% of gross rents
Cost of land–$200,000
Cost of constructing improvements–$750,000
No continuing involvement by seller

Computations:

Present value of 336 monthly payments on land lease at $965 discounted at 12% (imputed interest for a second lien receivable): $965 + ($965 x 96.432696)		$ 94,000
Loan from insurance company (primary debt)		760,000
Total debt or equivalent		854,000
Down payment		154,000
Sales value		$1,008,000

The initial investment ($154,000) is more than 15% of the sales value. (15% x $1,008,000 = $151,200).

The initial investment is also larger than the excess of the sales value over 115% of the primary debt.

Sales value	$1,008,000
115% of $760,000	874,000
Excess of sales value over 115% of debt	$ 134,000

Therefore, the initial investment of $154,000 is adequate, and recognizing profit on the sale of the improvements is appropriate.

Profit recognition:

Sales value		$1,008,000
Less: Cost of improvements	$750,000	
Cost of land	200,000	950,000
Profit recognized at time of sale		$ 58,000

The effect of including the present value of the lease is to reduce profit recognized by $106,000: $94,000 (present value of the land lease) – $200,000 (cost of land).

83. Subordinated Land Lease: Land Owned by Seller—Nonqualifying

Assumptions:

Sales price of improvements	$ 875,000
Represented by proceeds of:	
Cash down payment	$ 132,000
Loan by insurance company: first lien on the fee or on subordinated leasehold, 28-year term, 8 1/4%, payable in equal monthly installments of principal and interest	743,000
	$ 875,000

Land lease for 99 years @ $19,332/year, net, payable monthly in advance
Cost of land–-$200,000
Cost of improvements–-$750,000
No continuing involvement by seller

Computations:

Present value of 336 monthly payments on land lease of $1,611 discounted at 12% (imputed interest for a second lien receivable): $1,611 + ($1,611 × 96.432696)	$ 157,000
Loan from insurance company (primary debt)	743,000
Total debt or equivalent	900,000
Down payment	132,000
Sales value	$1,032,000

The initial investment ($132,000) is less than 15% of the sales value (15% × $1,032,000 = $154,800), and therefore is inadequate to recognize profit on sale of improvements. Profit recognized at time of sale should not exceed that recognizable under the installment method as if the subordinated lease were an installment receivable.

Profit recognition on installment method:

Sales value		$1,032,000
Less: Cost of improvements	$750,000	
Cost of land	200,000	950,000
Anticipated profit on sale of improvements		$ 82,000

Cash received or to be received by the seller, other than the proceeds of the primary loan, is:

Down payment	$ 132,000
Present value of land lease payments	157,000
	$ 289,000

The percentage of profit in each collection is therefore:

$$\frac{\$\ 82{,}000}{\$289{,}000} = 28.37\%$$

Profit recognizable in the period of sale is 28.37% of the down payment of $132,000, or $37,450. The remaining profit of $44,550 will be recognized at the rate of 28.37% of the portion of each lease payment that is equivalent to a reduction of principal on a loan of $157,000 for 28 years at 12%.

The effect of including the present value of the lease in the sales value of the improvements is to reduce the profit recognized on the improvements by $43,000: $157,000 (present value of the land lease) – $200,000 (cost of the land).

Exhibit II—Illustration of Profit Recognition—Sale of Property with Construction and Support Obligations by Seller

84. This exhibit illustrates the method of accounting required for a sale of property in which the seller is obligated to construct multifamily units and in which cash flow deficits are anticipated. The example applies to obligations of the seller specified in paragraphs 28-30.

85. Assumptions:

a. Company X develops and sells multifamily residential projects. The Company performs directly all developmental activities, including initial planning, site acquisition, obtaining of financing, and physical construction of the project.
b. During the year ended December 31, 19X1 the Company began a project of 100 units. The project was planned and substantial activity had been performed in 19X1 but physical construction had not started as of December 31, 19X1. However, all contracts had been let, and the Company had obtained construction financing.
c. On December 31, 19X1, the Company sold the project to a limited partnership syndication (fully formed) in which it is the sole general partner:

Sales value	$1,100,000
Represented by proceeds of:	
Cash down payment	$ 165,000
Permanent financing assumed by the buyer, consisting of a 28-year 8 1/2% fully amortizing first mortgage loan by a conventional lender, payable in equal monthly payments of principal and interest to maturity	825,000
Second mortgage note received by the Company payable in equal monthly installments including interest at 9 1/2% over 12 years	110,000
	$1,100,000

d. The closing occurred on December 31, 19X1 and included delivery or performance of the following:
   (1) The Company delivered to the buyer a legal title to the land and all existing improvements.
   (2) The Company delivered to the buyer a firm commitment from an outside lender for permanent financing, and the buyer assumed permanent financing formerly in the name of the Company.

(3) The Company received from the buyer $165,000 cash and a second mortgage note for $110,000.

(4) The Company signed a contract to deliver the completed project for a single price of $1,100,000.

e. Costs incurred by the Company and total costs estimated to complete the project, as of December 31, 19X1, were:

	Costs to Date	Estimated Costs to Complete	Total Estimated Costs
Land	$117,000		$117,000
Feasibility, zoning, architectural	35,000		35,000
Finance and other	85,000	$ 10,000	95,000
Site improvements		20,000	20,000
Building construction		571,000	571,000
Total	$237,000	$601,000	$838,000

f. The Company has completed an extensive market research and feasibility study analyzing its cost estimates, the rent-up incubation period, and subsequent rent levels. The initial rent-up will commence in 19X2. Accordingly, a support period of two years is presumed for 19X3 and 19X4.

g. Based on its market analysis, the projected results are as follows:

	19X2	19X3	19X4
Rental expense	$ 37,000	$ 58,000	$ 58,000
Debt service	93,000	93,000	93,000
Total	130,000	151,000	151,000
Rental revenue	(75,000)	(150,000)	(180,000)*
Anticipated net deficit (surplus) in cash flow	55,000	1,000	(29,000)
Safety factor of 1/3 of rental revenue	25,000	50,000	60,000
Adjusted anticipated net deficit in cash flow	$ 80,000	$ 51,000	$ 31,000

h. Initial cost estimates by the Company on previous projects have never varied from final costs by more than one-half of one % of total costs.

86. Calculations of Profit to Be Recognized:

Schedules A and B (paragraphs 87 and 88) illustrate calculations of profit to be recognized in the period of sale, in the period of construction, and in each period in which the seller will support operations (19X2 – 19X4). The following features should be noted:

a. The percentage of estimated total profit to be recognized each period is determined by the ratio of gross costs incurred to the end of the period to total estimated gross costs of the project, including gross costs during the period of support of operations. (Construction costs should be included even if construction is performed by parties other than the seller.)

b. The estimated total profit that is the basis of the calculation in each period (that is, the profit to which the percentage in (a) is applied) is determined by adding the sales value and two-thirds of the projected revenue during the period of support of operations and deducting the estimated total costs of the project, including costs of operating the property and debt service.
   (1) Actual amounts of revenue and costs are substituted for estimated amounts in the calculation as the actual amounts are known. However, in this illustration, remaining estimates of future revenue and expense are not changed because of actual results even though experience might indicate that projections of future amounts should be revised.
   (2) Projected and actual revenues in the calculation should exclude amounts that accrue to the buyer, for example, revenue in excess of the sum of operating expenses and debt service.
   (3) One-third of projected revenue should be excluded from the estimate of profit to provide a margin of safety (refer to paragraph 85(g)). Actual results incorporated in the calculation need not be reduced by a safety factor.
   (4) The calculation illustrated should be applied only if objective information is available regarding occupancy levels and rental rates for similar property in the immediate area. This will provide reasonable assurance that rent revenue from the project will be sufficient to cover operating expenses and debt service, including payments due to the seller under the terms of the transaction. Unless that evidence is available, no profit should be recognized on the transaction until rent revenue actually reaches levels that assure coverage of those costs.

c. Schedule A shows calculation of profit to be recognized each period on the assumption that actual revenue and costs are the same as those projected in paragraph 85(g) *adjusted* for the safety margin of one-third of revenue.

d. Schedule B shows calculation of profit to be recognized each period on the assumption that actual revenue and costs are the same as those projected in paragraph 85(g) *before* adjustment for safety margin.

e. Schedule C illustrates the calculation of estimated future rent receipts by adjustment for a safety margin.

87. **Schedule A**

Example of Profit Calculation
(assuming actual rental revenue equals *adjusted* projection)

REVENUES	
Sales value	$1,100,000
Adjusted—projected rental revenue[29]	50,000
19X2	100,000
19X3	120,000
19X4	1,370,000

COSTS	
Total estimated costs of project (paragraph 85(e))	838,000
Estimated rental expenses and debt service	
19X2	130,000
19X3	151,000
19X4	151,000
	1,270,000
TOTAL PROJECTED PROFIT	$ 100,000

Profit to be recognized:

$$\frac{\text{Cost to date}}{\text{Total costs}} \times \text{projected profit}$$

Profit recognized in period of sale:

$$\frac{\$\ 237{,}000}{1{,}270{,}000} \times \$100{,}000 = \$18{,}661$$

Total profit to date	$ 18,661
Less profit previously reported	0
Current profit recognition	$ 18,661

Profit recognized in period of construction:

$$\frac{\$\ 838{,}000}{1{,}270{,}000} \times \$100{,}000 = \$65{,}984$$

Total profit to date	$ 65,984
Less profit previously recognized	18,661
Current profit recognition	$ 47,323

Profit recognized during support period (19X2):

$$\frac{\$\ 968{,}000}{1{,}270{,}000} \times \$100{,}000 = \$76{,}221$$

Total profit to date	$ 76,221
Less profit previously recognized	65,984
Current profit recognition	$ 10,237

Profit recognized during support period (19X3):

$\frac{\$1{,}119{,}000}{1{,}270{,}000} \times \$100{,}000 = \$88{,}110$

Total profit to date	$ 88,110
Less profit previously recognized	76,221
Current profit recognition	$ 11,889

Profit recognized during support period (19X4):

$\frac{\$1{,}270{,}000}{1{,}270{,}000} \times \$100{,}000 = \$100{,}000$

Total profit to date	$ 100,000
Less profit previously recognized	88,110
Current profit recognition	$ 11,890

88. **Schedule B**

Example of Profit Calculation
(assuming actual rental revenue equals *unadjusted* projection)
(in thousands)

	Profit Recognized in Period of Sale	**Profit Recognized in Period of Construction**	**Profit Recognized during Support Period**		
			19X2	**19X3**	**19X4**
REVENUES					
Sales Value	$1,100	$1,100	$1,100	$1,100	$1,100
Adjusted—projected rental revenue*					
19X2	50	50	75†	75†	75†
19X3	100	100	100	150†	150†
19X4	120	120	120	150§	151‡
	1,370	1,370	1,395	1,475	1,476
COSTS					
Same as Schedule A	1,270	1,270	1,270	1,270	1,270
TOTAL PROJECTED PROFIT	$ 100	$ 100	$ 125	$ 205	$ 206

Profit to be recognized:

$$\frac{\text{Cost to date}}{\text{Total costs}} \times \text{projected profit}$$

Profit recognized in period of sale:

$$\frac{\$\ 237{,}000}{1{,}270{,}000} \times \$100{,}000 = \$18{,}661$$

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*Two-thirds of projected revenue during periods of support of operation; this can also be calculated as projected rental expenses plus projected debt service less projected deficit cash flow.

†Actual rental revenue.

‡Because the property has attained a level of occupancy in excess of the original adjusted projection, and there is no reason to believe that such occupancy level cannot be sustained, the projected 19X4 rental revenue should be adjusted to 19X3 actual rental revenue.

§Actual rental revenue excluding amounts not needed to meet cash flow requirements of the property.

Total profit to date	$ 18,661
Less profit previously reported	0
Current profit recognition	$ 18,661

Profit recognized in period of construction:

$$\frac{\$\ \ 838{,}000}{1{,}270{,}000} \times \$100{,}000 = \$65{,}984$$

Total profit to date	$ 65,984
Less profit previously reported	18,661
Current profit recognition	$ 47,323

Profit recognized during support period (19X2):

$$\frac{\$\ 968{,}000}{1{,}270{,}000} \times \$125{,}000 = \$95{,}276$$

Total profit to date	$ 95,276
Less profit previously reported	65,984
Current profit recognition	$ 29,292

Profit recognized during support period (19X3):

$\frac{\$1,119,000}{1,270,000} \times \$205,000 = \$180,626$

Total profit to date	$180,626
Less profit previously reported	95,276
Current profit recognition	$ 85,350

Profit recognized during support period (19X4):

$\frac{\$1,270,000}{1,270,000} \times \$206,000 = \$206,000$

Total profit to date	$206,000
Less profit previously reported	180,626
Current profit recognition	$ 25,374

89. **Schedule C**

Calculation of Adjusted Projected Rental Revenue

Assume an office building under development is sold together with an agreement to support operations of the property for three years. The projected annual rent roll is $1,000,000 of which $350,000 is supported by signed lease agreements. The projected rental revenue for the first year of operation is $600,000; the second year $750,000; and the third year $1,000,000. At the time of sale, the amounts to be included in the calculation would be as follows:

Year	Projected Rental Revenue	Safety Factor (33-1/3%)	Adjusted Projected Rental Revenue
1	$ 600,000	$200,000	$400,000
2	750,000	250,000	500,000
3	1,000,000	333,333	666,667

If at the time of sale there were signed lease agreements for $450,000, then the $450,000 would be used in year 1 because it is greater than the adjusted projected rental revenue. The adjusted projected rental revenue for years 2 and 3 would remain $500,000 and $666,667, respectively.

Exhibit III: Illustration of Profit Recognition—Installment Method, with Debt Assumed by Buyer

90. Assumptions:

Cash down payment	$ 150,000
Second mortgage payable by buyer to seller (10-year amortization of principal plus interest)	350,000
Total cash to be received by seller	500,000
First mortgage assumed by buyer (20-year amortization of principal plus interest)	500,000
Total sales price and sales value	1,000,000
Cost	600,000
Total profit	$ 400,000

The initial investment is assumed to be inadequate for full profit recognition, and the installment method of accounting is assumed to be appropriate. It is also assumed that, after the down payment, the buyer pays $25,000 of principal on the first mortgage and $35,000 of principal on the second mortgage.

Profit recognition: Under the installment method, profit recognition attributable to the down payment is $60,000, representing 40% ($400,000/$1,000,000) of $150,000.

Profit recognition attributable to the principal payments by the buyer on the first and second mortgages is $24,000, representing 40% of $60,000 ($25,000 + $35,000).

Appendix D: Illustrations of Calculations for Recognition of Profit on Retail Land Sales [30]

Exhibit I—Initial Measure of Consideration

(Percentage-of-Completion Method)
(amounts in thousands)

91. Assumptions:

Gross sales contracts recorded in year 1 (stated interest of 6%)	$ 1,000
Estimated uncollectible principal amount (sales contracts of $200* less estimated down payments to be forfeited of $20)	(180)
Net sales contracts receivable	820
Down payments and collections in year 1 relative to above sales contracts ($80 + $20)	100
Collections projected (principal amounts) for years 2 through 10	$ 720
Land cost (applicable to sales contracts of $800)	$ 60
Selling expenses in year 1	300

Future improvement costs (applicable to sales contracts of $800)	120
Minimum annual yield required on contracts receivable	12%

Discount Required:

Sales contracts receivable in year 1 (see above)	$ 720
Present value of 108 level monthly payments of $8.65 on sales contracts receivable (discounted at 12%) (Schedule A)	570
Discount required	$ 150

Computation of Revenue Applicable to Future Improvements:

$$\frac{\$120}{\$60 + \$300 + \$120} = 25\%$$

$25\% \times \$650$ ($1000 – $200 – $150) = $163

Profit Recognition in Year 1:

Revenue recognized:	
Cash received in year 1	$ 100
Present value of balance of sales contracts receivable	570
(Net sales $820, less discount $150)	670
Less: revenue applicable to future improvements	163
Net revenue	507
Less: Costs and expenses ($60 + $300)	360
Pretax income	$ 147

*It is assumed that experience shows that 90% of contracts in force 6 months after sales are recognized will ultimately be collected in full (paragraph 45).

Schedule A

Present Value of Sales Contracts Receivable

Year	Receivable Collections Principal	Receivable Collections Interest*	Annual Collections	Present Value @ 12%
2	$ 62	$ 42	$104	$ 97
3	66	38	104	87
4	70	34	104	77
5	75	29	104	68
6	79	25	104	60
7	84	20	104	53
8	89	15	104	47
9	95	9	104	43
10	100	4	104	38
	$720	$216	$936	$570

*Assumes no interest for year 1.

93. **Schedule B**

Computation of Interest Income for Financial Reporting Purposes (amounts in thousands)

Year	Debit: Cash	Debit: Unamortized Valuation Discount	Credit: Contracts Receivable	Credit: Interest Income*
2	$104	$ 24	$ (62)	$ (66)
3	104	24	(66)	(62)
4	104	22	(70)	(56)
5	104	21	(75)	(50)
6	104	19	(79)	(44)
7	104	16	(84)	(36)
8	104	12	(89)	(27)
9	104	8	(95)	(17)
10	104	4	(100)	(8)
	$936	$150	$(720)	$ (366)

*Total interest income equals $216 stated interest plus $150 discount, or $366.

94. **Schedule C**

Determination of Income Tax Payable
(amounts in thousands)

Year	Principal Receipts	Profit from Installment Sale	Interest Income from Receivable	Selling Expense	Taxable Income (Loss)	Tax	Tax Effect of Loss Carry-forward from Year 1	Net Tax
1	$100	$ 82*		($300)	($218)			
2	62	48	$ 42		90	($43)	$ 43	
3	66	51	38		89	(43)	43	
4	70	54	34		88	(42)	19	($ 23)
5	75	58	29		87	(42)		(42)
6	79	61	25		86	(41)		(41)
7	84	65	20		85	(41)		(41)
8	89	69	15		84	(40)		(40)
9	95	74	9		83	(40)		(40)
10	100	78	4		82	(40)		(40)
	$820	$640	$216	($300)	$556	($372)	$105†	($267)

Assumption: The installment method is used for income tax purposes.

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* Profit on land sale computed on installment method as follows:

Gross profit = $800 – $180 = $620

Principal payment X profit margin: $\$80 \times \frac{\$620}{\$800} = \$62$

Forfeited down payments 20

$82

†Carryforward amount is 48% of $218 = $105.

95. **Schedule D**

Percentage-of-Completion Method-Illustration of Financial Statement Presentation of Transactions Assumed in Paragraph 91
(amounts in thousands)

		End of Year									
Balance Sheets	**Beginning of Year 1**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Assets:											
Cash	$300	$100	$204	$308	$389	$451	$514	$547	$581	$615	$649
Contracts receivable		720	658	592	522	447	368	284	195	100	
Less: Allowance for contract cancellations*		—									
Unamortized valuation discount		(150)	(126)	(102)	(80)	(59)	(40)	(24)	(12)	(4)	
		570	532	490	442	388	328	260	183	96	
Land	75	15	15	15	15	15	15	15	15	15	15
	$375	$685	$751	$813	$846	$854	$857	$822	$779	$726	$664
Liabilities and equity:											
Deferred income taxes		$ 71	$103	$133	$137	$119	$100	$ 81	$ 59	$ 32	
Revenue applicable to future improvements†		163	163	163	163	163	163	122	81	40	
Capital stock	$375	375	375	375	375	375	375	375	375	375	$375
Retained earnings		76	110	142	171	197	219	244	264	279	289
	$375	$685	$751	$813	$846	$854	$857	$822	$779	$726	$664

Income Statements	1	2	3	4	5	6	7	8	9	10	Total
	Year										
Revenues:											
Gross Sales	$1,000										$1,000
Less:											
Estimated uncollectible sales	(180)										(180)
Revenue applicable to future improvements	(163)										(163)
Valuation discount	(150)										(150)
Net sales	507										507
Improvement revenue–prior sales							$ 41	$ 41	$ 41	$ 40	163
Interest income (Schedule B)		$ 66	$ 62	$ 56	$ 50	$ 44	36	27	17	8	366
	507	66	62	56	50	44	77	68	58	48	1,036

Costs and expenses:											
Cost of sales	60										60
Improvement costs—prior sales							30	30	30	30	120
Selling expenses	300										300
	360						30	30	30	30	480
Income before provision for income taxes	147	66	62	56	50	44	47	38	28	18	556
Provision for income taxes:											
Current				23	42	41	41	40	40	40	267
Deferred	71	32	30	4	(18)	(19)	(19)	(22)	(27)	(32)	
	71	32	30	27	24	22	22	18	13	8	267
Net Income	$ 76	$ 34	$ 32	$ 29	$ 26	$ 22	$ 25	$ 20	$ 15	$ 10	$ 289

* Assumes that all cancellations occurred in year 1 without refunds of down payments.
† Assumes that future performance occurred equally in years 7, 8, 9, and 10.
Note: The illustrative statements are not intended to represent retail land sales company financial statements because they include only items necessary to illustrate timing of revenue and income recognition.

EXHIBIT II—INSTALLMENT METHOD

96. **Schedule A**

Illustration of Financial Statement Presentation
Based on Assumptions in Paragraph 91
(amounts in thousands)

		End of Year									
Balance Sheets	**Beginning Of Year 1**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Assets:											
Cash	$300	$100	$204	$308	$389	$451	$514	$547	$581	$615	$649
Contracts receivable		720	658	592	522	447	368	284	195	100	
Less: Profit applicable to future improvements		(342)	(313)	(282)	(249)	(213)	(175)	(135)	(93)	(48)	
		378	345	310	273	234	193	149	102	52	
Land	75	15	15	15	15	15	15	15	15	15	15
	$375	$493	$564	$633	$677	$700	$722	$711	$698	$682	$664
Liabilities and equity:											
Deferred income taxes			$ 33	$ 66	$ 75	$ 64	$ 54	$ 42	$ 29	$ 15	
Liability for future improvements		$120	120	120	120	120	120	90	60	30	
Capital stock	$375	375	375	375	375	375	375	375	375	375	$375
Retained earnings (deficit)		(2)	36	72	107	141	173	204	234	262	289
	$375	$493	$564	$633	$677	$700	$722	$711	$698	$682	$664

Income Statements	Point of Sale in Year 1	1	2	3	4	5	6	7	8	9	10	Total
						Year						
Revenues:												
Sales	$1,000	$1,000										$1,000
Interest Income			$ 42	$ 38	$ 34	$ 29	$ 25	$ 20	$ 15	$ 9	$ 4	216
Profit Deferred*	(427)	(427)										(427)
Profit recognized†			29	31	33	36	38	40	42	45	48	342
	573	573	71	69	67	65	63	60	57	54	52	1,131
Costs and expenses:												
Cost of Sales‡	225	225										225
Selling expenses	300	300										300
Loss on cancellations§		50										50
	525	575										575
Income (loss) before provision for income taxes	48	(2)	71	69	67	65	63	60	57	54	52	556
Provision for income taxes:												
Current					23	42	41	41	40	40	40	267
Deferred	23		33	33	9	(11)	(10)	(12)	(13)	(14)	(15)	
	23		33	33	32	31	31	29	27	26	25	267
Net Income (loss)	$ 25	($ 2)	$ 38	$ 36	$ 35	$ 34	$ 32	$ 31	$ 30	$ 28	$ 27	$289

See Notes to Exhibit II, Schedule A, on next page.

Notes to Exhibit II, Schedule A:

		(amounts in thousands)
*Computation of profit deferred:		
Sales		$1,000
Cost of sales (see Note‡)		(225)
Selling expense		(300)
Profit		$ 475
Percentage		47.5%
Uncollected receivables		$ 900
Profit percentage		47.5%
Profit deferred		$ 427

†Profit recognized is 47.5% of principal collections.

‡Costs applicable to *gross* sales contracts:		
Land		$ 75
Future development		150
		$ 225

§Loss on cancellations:		
Contracts cancelled in Year 1		$ 200
Unpaid balance		$ 180
Costs recovered (credited to cost of sales):		
Land at cost	$15	
Future development	30	(45)
Profit at 47.5% of $180		(85)
Unrecovered selling cost		$ 50

97. **Schedule B**

Installment Method Changed to Percentage-of-Completion Method at Beginning of Year 4
(amounts in thousands)

	End of Year									
Balance Sheets	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Assets:										
Cash	$100	$204	$308	$389	$451	$514	$547	$581	$615	$649
Contracts receivable	720	658	592	522	447	368	284	195	100	
Less:										
Profit applicable to future improvements	(342)	(313)	(282)							
Unamortized valuation discount				(80)	(59)	(40)	(24)	(12)	(4)	
	378	345	310	442	388	328	260	183	96	
Land	15	15	15	15	15	15	15	15	15	15
	$493	$564	$633	$846	$854	$857	$822	$779	$726	$664
Liabilities and equity:										
Deferred income taxes		$ 33	$ 66	$137	$119	$100	$ 81	$ 59	$ 32	
Liability for future improvements (revenue applicable to future improvements after Year 3)	$120	120	120	163	163	163	122	81	40	
Capital stock	375	375	375	375	375	375	375	375	375	$375
Retained earnings (deficit)	(2)	36	72	171	197	219	244	264	279	289
	$493	$564	$633	$846	$854	$857	$822	$779	$726	$664

Income Statements	Year 1	2	3	4	5	6	7	8	9	10
Revenues:										
Gross sales contracts recorded	$1,000									
Improvement revenue—prior sales							$41	$41	$ 41	$ 40
Profit deferred	(427)									
Profit recognized		$29	$31							
Interest income*		42	38	$56	$50	$44	36	27	17	8
Income resulting from change from installment to percentage-of-completion method† (described fully in notes to financial statements)				137						
	573	71	69	193	50	44	77	68	58	48
Costs and expenses:										
Cost of Sales	225									
Improvement costs—prior sales							30	30	30	30
Selling expenses	300									
Loss on cancellations	50									
	575						30	30	30	30
Income (loss) before provision for income taxes	(2)	71	69	193	50	44	47	38	28	18
Provision for income taxes:										
Current				23	42	41	41	40	40	40
Deferred		33	33	71	(18)	(19)	(19)	(22)	(27)	(32)
		33	33	94	24	22	22	18	13	8
Net income (loss)	($ 2)	$38	$36	$ 99	$26	$22	$25	$20	$ 15	$ 10

See Notes to Exhibit II, Schedule B, on next page.

Notes to Exhibit II, Schedule B:

*Interest at stated rate for Years 2 and 3; 12% after change from installment to percentage-of-completion method.

†Computation of effect of change from installment to percentage-of-completion method:

	(Amounts in thousands)	
Profit not yet recognized under installment method:		
Original	$427	
Recognized in prior years	(60)	
Applicable to canceled contracts	(85)	$282
Less, valuation discount required:		
Receivables at beginning of Year 4	592	
Present value of payments due (principal and interest) at 12%	(490)	102
		180
Less:		
Revenue to be recognized in future as performance takes place	163	
Costs to be recognized in future	(120)	43
Net amount credited to income (before taxes)		$137

Appendix E: BACKGROUND INFORMATION AND SUMMARY OF CONSIDERATION OF COMMENTS ON EXPOSURE DRAFT

98. As discussed in FASB Statement No. 32, *Specialized Accounting and Reporting Principles and Practices in AICPA Statements of Position and Guides on Accounting and Auditing Matters,* the FASB is extracting the specialized [31] accounting and reporting principles and practices from AICPA Statements of Position (SOPs) and Guides on accounting and auditing matters and issuing them as FASB Statements after appropriate due process. This Statement extracts the specialized sale and profit recognition principles and practices from the AICPA Industry Accounting Guides, *Accounting for Profit Recognition on Sales of Real Estate and Accounting for Retail Land Sales,* and SOPs 75-6, *Questions Concerning Profit Recognition on Sales of Real Estate,* and 78-4, *Application of the Deposit, Installment, and Cost Recovery Methods in Accounting for Sales of Real Estate.* The provisions of the retail land sales Guide that address costs have been included in FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects.*

99. Board members have assented to the issuance of this Statement on the basis that it is an appropriate extraction of existing specialized principles and practices and that a comprehensive reconsideration of those principles and practices was not contemplated in undertaking this FASB project. Most of the background material and discussion of accounting alternatives has not been carried forward from the Guides and SOPs. The Board's conceptual framework project on accounting recognition criteria will address recognition issues relating to elements of financial statements. A Statement of Financial Accounting Concepts resulting from that project in due course will serve as a basis for evaluating existing standards and practices. Accordingly, the Board may wish to evaluate the standards in this Statement when its conceptual framework project is completed. However, the Board concluded that this Statement should not be postponed indefinitely to await completion of a Statement of concepts on recognition issues.

100. Retail land sales are sales, on a volume basis, of lots that are subdivisions of large tracts of land. They are characterized by down payments so small that local banks and savings and loan institutions would not loan money on the property at market rates or purchase the buyer's note for the remaining purchase price without a substantial discount. The seller is unable to enforce the sales contract or the buyer's note against the buyer's general credit. If the buyer cancels the contract within an established cancellation period, its money is refunded. Defaults by the buyer after the cancellation period result in recovery of the land by the seller and forfeiture of at least some principal payments made by the buyer.[32]

101. Examples of real estate sales transactions that are not retail land sales include sales of lots to builders; sales of homes, buildings, and parcels of land to builders and others; sales of corporate stock of enterprises with substantial real estate, sales of partnership interests,[33] and sales of time-sharing interests [34] if the sales are in substance sales of real estate; and sales of options to purchase real estate.

102. The retail land sales Guide was developed to clarify and standardize accounting for retail land sales, particularly the timing and methods of revenue and profit recognition. The Guide recommended conditions to be met by both the buyer and the seller before the seller reported a sale. It also recommended criteria for the use of the full accrual, percentage-of-completion, and installment methods for recognizing profit.

103. The profit recognition Guide addressed real estate sales transactions other than retail land sales. It was developed to standardize accounting for transactions that had become increasingly diverse and complex. The Guide addressed the timing of profit recognition and recommended criteria for determining appropriate methods for profit recognition. SOPs 75-6 and 78-4 clarified and elaborated on the recommendations of the Guide.

104. A draft of this Statement was reviewed by the FASB Task Force on Specialized Principles for the Real Estate Industry to ensure that the specialized principles in the Guides and SOPs had been extracted correctly. Based on the task force's comments, the Board believes that the specialized profit recognition principles in the Guides and SOPs have been correctly identified

and included in this Statement.

105. An Exposure Draft of a proposed FASB Statement, *Accounting for Sales of Real Estate,* was issued on December 15, 1981. The Board received 47 comment letters in response to the Exposure Draft. Certain of the comments received and the Board's consideration of them are discussed in this appendix.

Accounting for Sales of Time-Sharing Interests

106. The Exposure Draft proposed that sales of time-sharing interests in real estate that represent either fee simple ownership or are sales-type leases under Statement 13 should be accounted for as sales of real estate other than retail land sales under the provisions of this Statement. Sales of time-sharing interests were not addressed in the Guides and SOPs whose principles are extracted in this Statement.

107. The majority of respondents commenting on this issue agreed that accounting for sales of time-sharing interests should be covered in this Statement and that the accounting proposed in the Exposure Draft is appropriate. Some respondents felt that accounting for sales of time-sharing interests in real estate should not be dealt with as part of this Statement because the Guides and SOPs being extracted did not deal with that subject. Other respondents believe that this Statement should provide additional guidance on accounting for revenue and costs of time-sharing interests.

108. The Board concurred with those respondents who believe that it is appropriate to require that sales of real estate time-sharing interests be accounted for in accordance with the provisions of this Statement but that additional guidance should not be provided as part of this extraction project.

Discount Rate for Valuation of Retail Land Sales Receivables

109. Paragraph 79(a) of the Exposure Draft proposed that a net retail land sales receivable be valued at an amount at which it could be sold on a volume basis without recourse to the seller at the time of the initial transaction. It referred to APB Opinion No. 21, *Interest on Receivables and Payables,* for guidance on selection of an appropriate interest rate. The retail land sales Guide had provided a more specific recommendation—that those receivables be discounted at a rate not less than the rate charged locally for financing installment purchases of soft goods and appliances.

110. Many respondents agreed that the guidance proposed in the Exposure Draft was appropriate. Others suggested that additional guidance be provided as to selection of a discount rate, such as the seller's incremental borrowing rate, the yield rate established by recent sales of Government National Mortgage Association (GNMA) securities, or an average rate charged by local savings and loan associations. Other respondents objected to the principle of valuing

receivables at an amount at which they could be sold on a volume basis without recourse. They believe that there is not a market for this type of paper or an opportunity for nonrecourse discounting with lending institutions.

111. The Board believes that determination of an appropriate interest rate should be governed by the principles of Opinion 21 and that designation of specific rates would be arbitrary. Therefore, the Board believes that the general guidance proposed in the Exposure Draft should be retained. However, the idea of valuation at the amount at which receivables could be sold without recourse has been expressed as an objective rather than as a prescribed methodology.

Condensed Disclosure Requirements

112. The Exposure Draft proposed that certain detailed disclosures that were recommended by the retail land sales Guide not be required by this Statement because they are already required by other authoritative literature. Most of the comment letters agreed with that proposal. A few respondents suggested adding specific disclosures or eliminating one or more specific items, but those suggestions were not generally supported. The Board considered those suggestions and determined that no significant changes should be made to the Exposure Draft.

Loans to Buyers by Sellers of Real Estate

113. The Exposure Draft noted that financing institutions occasionally sell land and make development or construction loans to the buyers. It proposed that the buyer's initial investment not include such funds and that anticipated future loans from the seller be subtracted from the initial and continuing investments.

114. Several respondents agreed with that provision. Others disagreed and suggested that it is not appropriate to subtract future loans from sellers that are established lending institutions if those loans will be used to add value to the property, especially if the future loan is on normal lending terms. They agreed, however, that the future loans should not be included as part of the buyer's initial investment.

115. The Board has considered those comments and concluded that future loans from an established lending institution need not be subtracted if (a) they are on normal terms, (b) they bear fair-market interest rates, and (c) the proceeds of the loans are conditional on use for specified development of or construction on the property. Those requirements are designed to preclude an effective reduction in the buyer's investment in the property to less than the minimum requirement by a subsequent loan from the seller.

Sale and Leaseback of Real Estate

116. Several respondents recommended that paragraph 8 of the Exposure Draft clarify the relative applicability of this Statement and FASB Statements 13 and 28. Paragraph 40 of this

Statement has been added to indicate that (a) recognition of a sale in a sale-leaseback shall be governed by Statements 13 and 28, (b) the amount of the profit on sale-leaseback transactions is to be determined by the provisions of this Statement, and (c) the profit so determined is to be accounted for in accordance with the provisions of Statements 13 and 28 unless other provisions of this Statement require postponement of profit recognition until a later event.

Due Process

117. Several respondents questioned the appropriateness of extracting specialized accounting principles from AICPA documents that had not been subjected to the FASB's extensive due process procedures. They noted the Guides and SOPs were promulgated through a process that did not include input from industry, academe, or the general public and that those documents were not exposed for comments before they were issued.

118. The extraction process is described in paragraph 98 of this Statement, paragraphs 1-9 of Statement 32, and the FASB's *Request for Written Comments on an FASB Proposal for Dealing with Industry Accounting Matters and Accounting Questions of Limited Application.* Input from the public has been received and carefully considered:

a. At a meeting of the Financial Accounting Standards Advisory Council in July 1978 at which the extraction process was discussed
b. In the form of 157 letters of comment on the request for written comments described above
c. In the form of 53 letters of comment in response to the Exposure Draft, *Specialized Accounting and Reporting Principles and Practices in AICPA Industry Accounting Guides, Industry Audit Guides, and Statements of Position*
d. At two meetings of the FASB Task Force on Specialized Principles for the Real Estate Industry in 1981
e. In extensive oral and written comments from task force members on several drafts of the Exposure Draft, *Accounting for Sales of Real Estate,* and of this Statement
f. In the form of 47 letters of comment on the Exposure Draft

The Board believes it has followed its required due process procedures and that it is appropriate to issue this Statement.

Other

119. Several respondents suggested various substantive changes to the Exposure Draft. Adoption of those suggestions would have required a reconsideration of some of the provisions of the Guides and SOPs. Such a reconsideration is not contemplated in the extraction project unless a proposed change meets one of the three criteria for change included in the "Notice for Recipients" section of the Exposure Draft or is broadly supported. The proposed changes did not meet the criteria for change and were not broadly supported. Accordingly, the Board did not adopt those suggestions. However, based on suggestions from respondents to the Exposure

Draft, the Board has made several other changes, including an internal reorganization of this Statement, that it believes clarify the Statement.

120. It was suggested that compliance with this Statement would be burdensome to small practitioners and enterprises that sell real estate infrequently. In response to that suggestion, the Board considered limiting the scope and applicability of this Statement, for example, to publicly held enterprises and privately owned real estate enterprises. However, the Board believes further consideration is necessary before income measurement standards such as those in this Statement are applied differently based on the size or form of ownership of an enterprise. The Board notes that its project on financial reporting by private and small public companies will consider characteristics of those enterprises and how their financial reporting needs differ from those of other business enterprises. The Board may reconsider the need for applying some or all of the provisions of this Statement to certain private and small public enterprises when that project is completed.

121. In its August 1982 report, the Structure Committee of the Financial Accounting Foundation recommended that the Board develop a plan to provide timely guidance for implementation questions (pages 18 and 19 of the report). The committee also said it believes the program to extract specialized accounting standards from AICPA pronouncements and issue them as FASB Statements is consistent with the Board's mission (page 18 of the report).

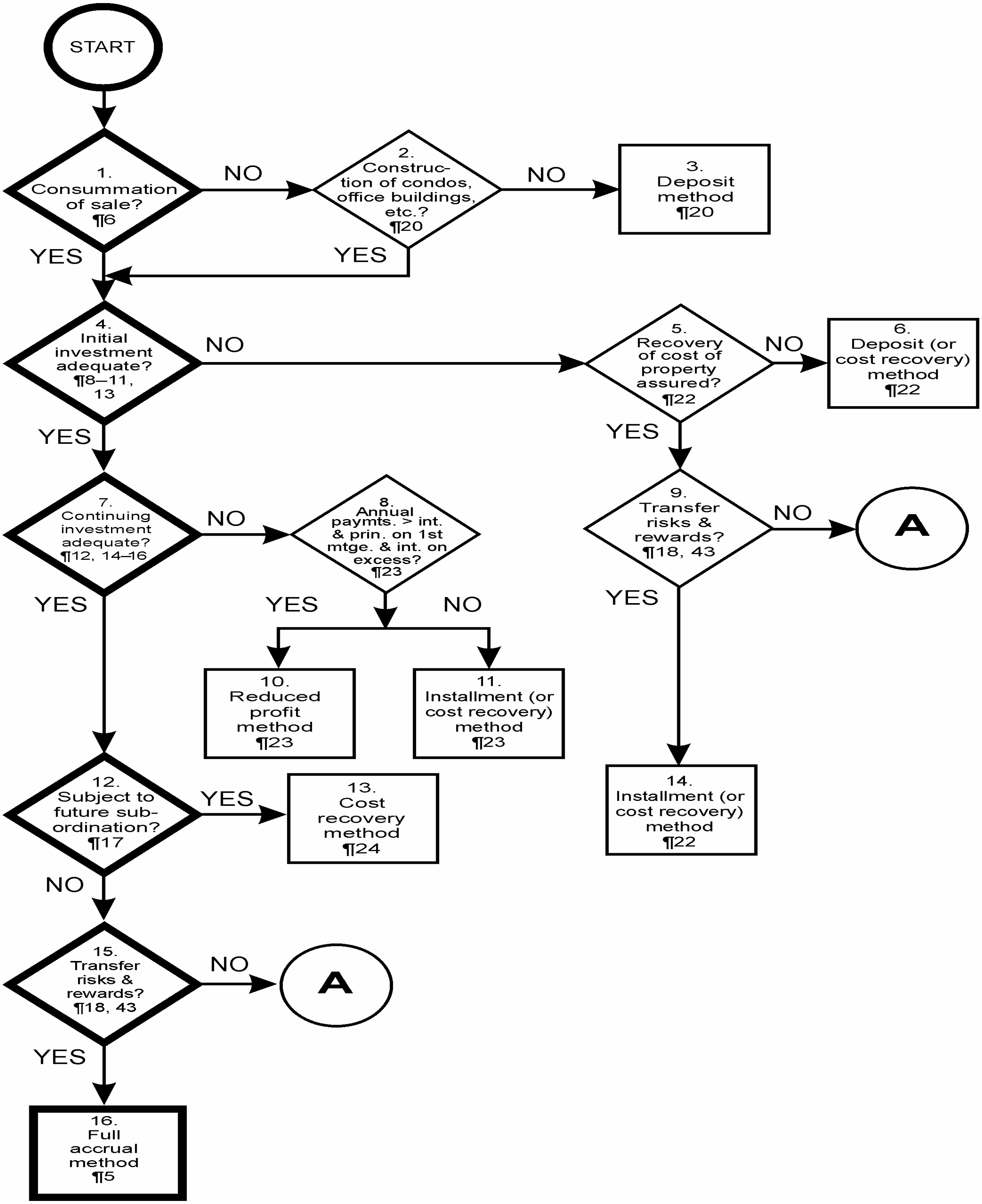
122. The Board has concluded that it can reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraph 52 are advisable in the circumstances.

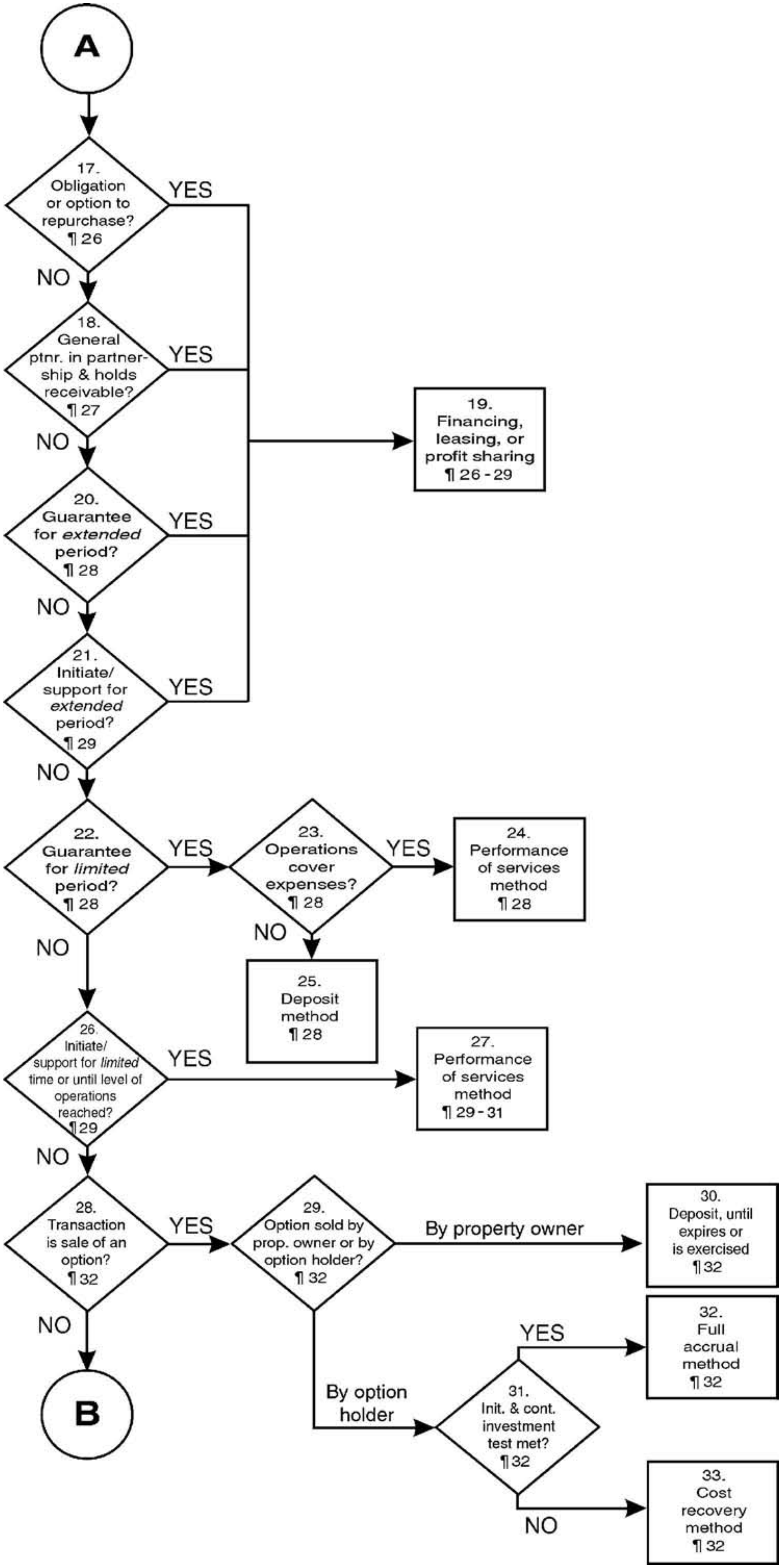
Appendix F: DECISION TREES

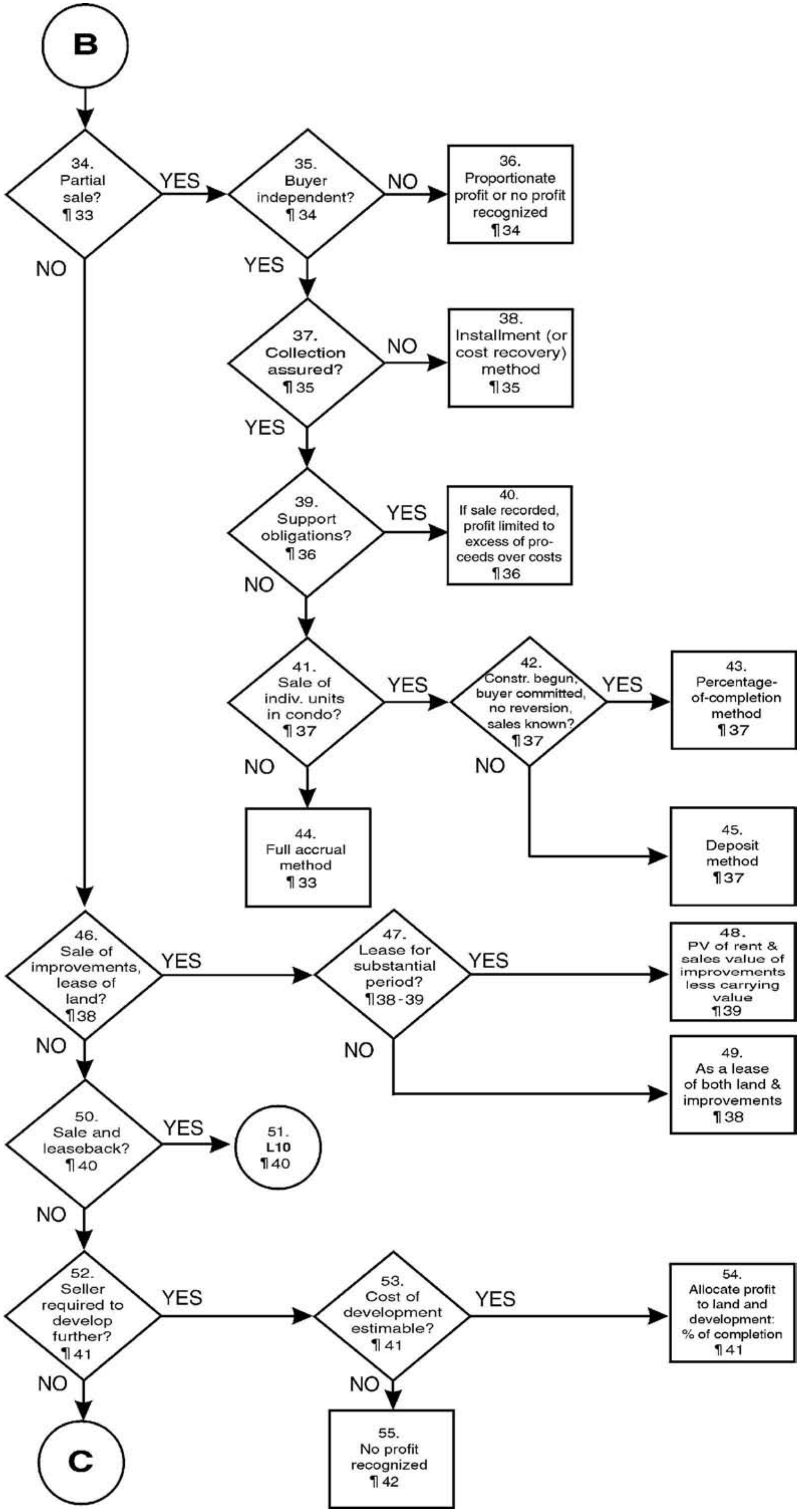
123. The following decision trees are intended to provide an overview of the major provisions in this Statement that relate to the accounting for sales of real estate. They should not be used without further reference to the Statement. Two decision trees are provided—one for retail land sales and a second for all other sales of real estate. The highlighted boxes on this page describe the general requirements for recognizing all of the profit on a sale of real estate other than a retail land sale at the date of sale.

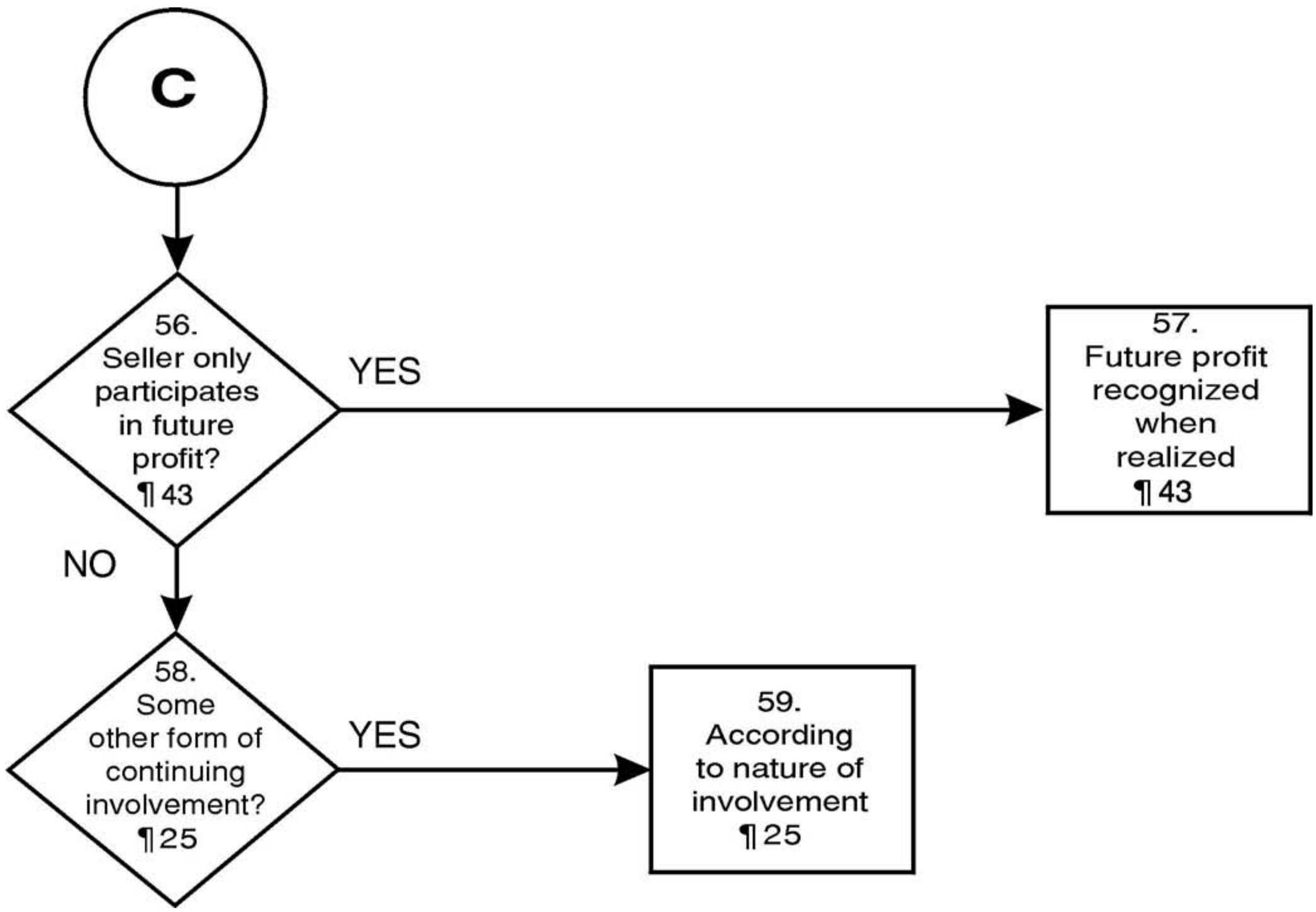
[The decision trees have been deleted in the electronic version of *Original Pronouncements*. If there is a need to reference these decision trees, please refer to the printed version of *Original Pronouncements*.]

Sales of Real Estate
Other Than Retail Land Sales

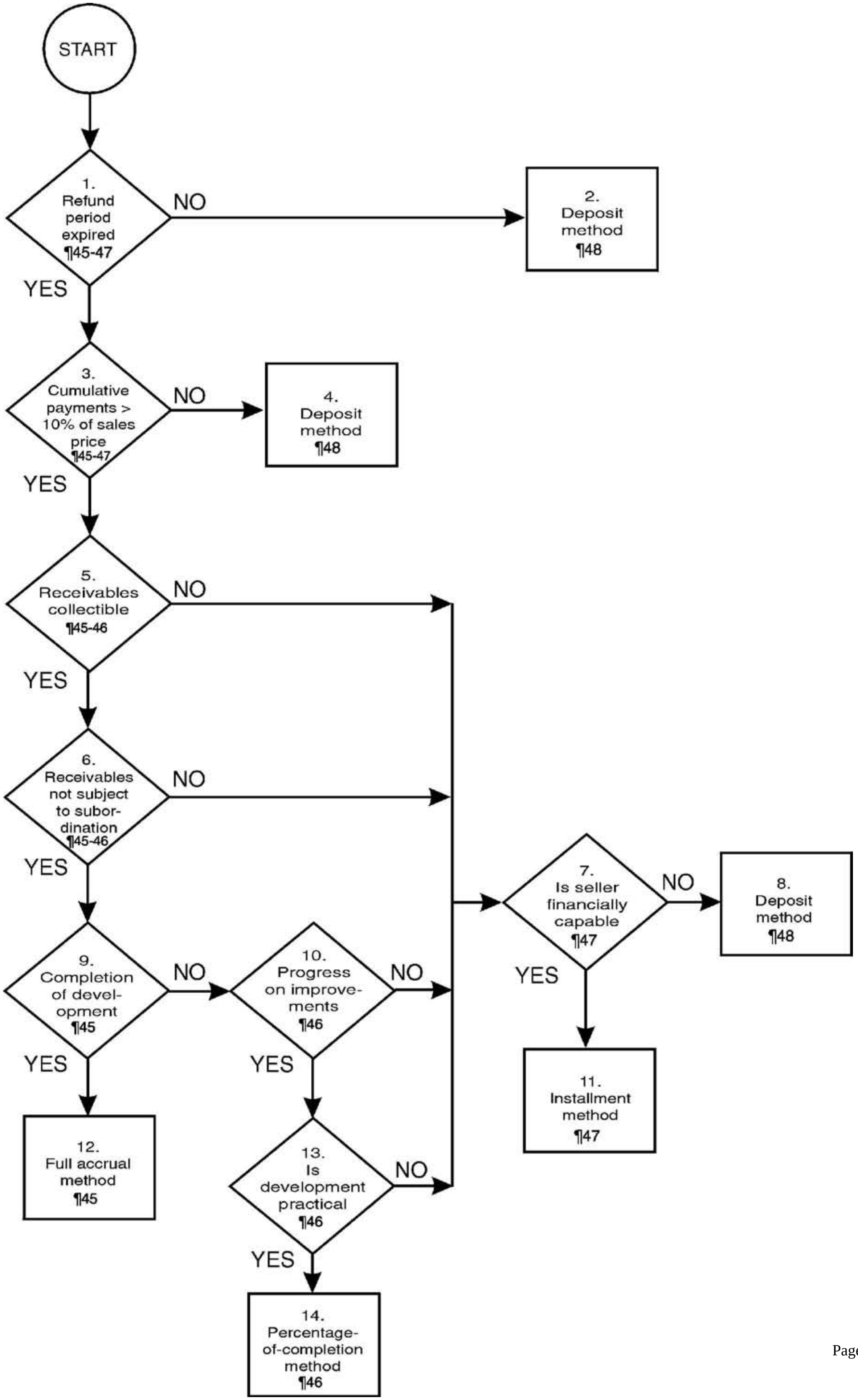



A
17. Obligation or option to repurchase? ¶ 26
YES
NO
18. General ptnr. in partnership & holds receivable? ¶ 27
YES
NO
19. Financing, leasing, or profit sharing ¶ 26 - 29
20. Guarantee for *extended* period? ¶ 28
YES
NO
21. Initiate/ support for *extended* period? ¶ 29
YES
NO
22. Guarantee for *limited* period? ¶ 28
YES
NO
23. Operations cover expenses? ¶ 28
YES
NO
24. Performance of services method ¶ 28
25. Deposit method ¶ 28
26. Initiate/ support for *limited* time or until level of operations reached? ¶ 29
YES
NO
27. Performance of services method ¶ 29 - 31
28. Transaction is sale of an option? ¶ 32
YES
NO
29. Option sold by prop. owner or by option holder? ¶ 32
By property owner
30. Deposit, until expires or is exercised ¶ 32
By option holder
31. Init. & cont. investment test met? ¶ 32
YES
32. Full accrual method ¶ 32
NO
33. Cost recovery method ¶ 32
B


B
34. Partial sale? ¶ 33
YES
NO
35. Buyer independent? ¶ 34
NO
YES
36. Proportionate profit or no profit recognized ¶ 34
37. Collection assured? ¶ 35
NO
YES
38. Installment (or cost recovery) method ¶ 35
39. Support obligations? ¶ 36
YES
NO
40. If sale recorded, profit limited to excess of proceeds over costs ¶ 36
41. Sale of indiv. units in condo? ¶ 37
YES
NO
42. Constr. begun, buyer committed, no reversion, sales known? ¶ 37
YES
NO
43. Percentage-of-completion method ¶ 37
44. Full accrual method ¶ 33
45. Deposit method ¶ 37
46. Sale of improvements, lease of land? ¶ 38
YES
NO
47. Lease for substantial period? ¶ 38-39
YES
NO
48. PV of rent & sales value of improvements less carrying value ¶ 39
49. As a lease of both land & improvements ¶ 38
50. Sale and leaseback? ¶ 40
YES
NO
51. L10 ¶ 40
52. Seller required to develop further? ¶ 41
YES
NO
53. Cost of development estimable? ¶ 41
YES
NO
54. Allocate profit to land and development: % of completion ¶ 41
55. No profit recognized ¶ 42
C


C
56.
Seller only
participates
in future
profit?
¶ 43
YES
57.
Future profit
recognized
when
realized
¶ 43
NO
58.
Some
other form of
continuing
involvement?
¶ 25
YES
59.
According
to nature of
involvement
¶ 25

Retail Land Sales



Footnotes

FAS66, Footnote 1--Profit on a sale of a partial interest in real estate shall be subject to the same criteria for profit recognition as a sale of a whole interest.

FAS66, Footnote 2--Paragraph 20 provides an exception to this requirement if the seller is constructing office buildings, condominiums, shopping centers, or similar structures.

FAS66, Footnote 3--An "independent established lending institution" is an unrelated institution such as a commercial bank unaffiliated with the seller.

FAS66, Footnote 4--As an example, if unimproved land is sold for $100,000, with a down payment of $50,000 in cash, and the seller plans to loan the buyer $35,000 at some future date, the initial investment is $50,000 minus $35,000, or $15,000.

FAS66, Footnote 5--Paragraph 24 of FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects,* specifies the accounting for an excess of costs over net realizable value for property that has not yet been sold.

FAS66, Footnote 6--Paragraphs 13 and 14 of APB Opinion No. 21, *Interest on Receivables and Payables,* provide criteria for selecting an appropriate rate for present-value calculations.

FAS66, Footnote 7--A right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase.

FAS66, Footnote 8--For this purpose, a significant receivable is a receivable in excess of 15 percent of the maximum first-lien financing that could be obtained from an independent established lending institution for the property. It would include:

a. A construction loan made or to be made by the seller to the extent that it exceeds the minimum funding commitment for permanent financing from a third party that the seller will not be liable for
b. An all-inclusive or wraparound receivable held by the seller to the extent that it exceeds prior-lien financing for which the seller has no personal liability
c. Other funds provided or to be provided directly or indirectly by the seller to the buyer
d. The present value of a land lease when the seller is the lessor (footnote 15)

FAS66, Footnote 9--Guarantees by the seller may be limited to a specified period of time.

FAS66, Footnote 10--Support shall be presumed to be required if: (a) a seller obtains an interest as a general partner in a limited partnership that acquires an interest in the property sold; (b) a seller retains an equity interest in the property, such as an undivided interest or an equity interest in a joint venture that holds an interest in the property; (c) a seller holds a receivable from a buyer for a significant part of the sales price and collection of the receivable depends on the operation of the property; or (d) a seller agrees to manage the property for the buyer on terms not usual for the services to be rendered, and the agreement is not terminable by either the seller or the buyer.

FAS66, Footnote 11--When an option to purchase real estate is sold by an option holder, the sales value includes the exercise price of the option and the sales price of the option. For example, if the option is sold for $150,000 ($50,000 cash and a $100,000 note) and the exercise price is $500,000, the sales value is $650,000.

FAS66, Footnote 12--A condominium project may be a building, a group of buildings, or a complete project.

FAS66, Footnote 13--Construction is not beyond a preliminary stage if engineering and design work, execution of construction contracts, site clearance and preparation, excavation, and completion of the building foundation are incomplete.

FAS66, Footnote 14--The buyer may be able to require a refund, for example, if a minimum status of completion of the project is required by state law and that status has not been attained; if state law requires that a "Declaration of Condominium" be filed and it has not been filed, except that in some states the filing of the declaration is a routine matter and the lack of such filing may not make the sales contract voidable; if the sales contract provides that permanent financing at an acceptable cost must be available to the buyer at the time of closing and it is not available; or if the condominium units must be registered with either the Office of Interstate Land Sales Registration of the Department of Housing and Urban Development or the Securities and Exchange Commission, and they are not so registered.

FAS66, Footnote 15--The present value of the specified rental payments is the present value of the lease payments specified in the lease over the term of the primary indebtedness, if any, on the improvements, or over the customary amortization term of primary debt instruments on the type of improvements involved. The present value is computed at an interest rate appropriate for (a) primary debt if the lease is not subordinated or (b) secondary debt if the lease is subordinated to loans with prior liens.

FAS66, Footnote 16--Paragraph 17 of FASB Statement No. 5, *Accounting for Contingencies,* addresses accounting for gain contingencies.

FAS66, Footnote 17--A retail land sales "project" is a homogeneous, reasonably contiguous area of land that may, for development and marketing, be subdivided in accordance with a master plan.

FAS66, Footnote 18--Retail land sales shall be considered consummated when all of the criteria in paragraph 47 are met.

FAS66, Footnote 19--The six-month period is solely a test of eligibility for the accrual method and is not intended to restrict the recognition of profit before the six-month period expires.

FAS66, Footnote 20--Examples of sales methods include telephone sales, broker sales, and site-visitation sales.

FAS66, Footnote 21--In the AICPA Guide, *Accounting for Retail Land Sales,* this was called the "accrual method."

FAS66, Footnote 22--The credit to income resulting from the change is the profit not yet recognized less (a) a discount, if required, to reduce the receivable balances to their present values at the date of change to the percentage-of-completion method (using the appropriate interest rates, as specified in paragraphs 13 and 14 of Opinion 21, in effect at the time of the original sales) and (b) the liability (also discounted) for remaining future performance. The computation is illustrated in paragraph 97.

FAS66, Par. 54, Footnote a–If collectibility of the remaining portion of the sales price cannot be supported by reliable evidence of collection experience, the minimum initial investment shall be at least 60 percent of the difference between the sales value and the financing available from loans guaranteed by regulatory bodies such as the Federal Housing Authority (FHA) or the Veterans Administration (VA), or from independent, established lending institutions. This 60-percent test applies when independent first-mortgage financing is not utilized and the seller takes a receivable from the buyer for the difference between the sales value and the initial investment. If independent first mortgage financing is utilized, the adequacy of the initial investment on sales of single-family residential property should be determined in accordance with paragraph 53.

FAS66, Footnote 23--For an all-inclusive or "wrap-around" receivable held by the seller, interest collected is recognized as income to the extent of, and as an appropriate offset to, interest expense on prior-lien financing for which the seller remains responsible.

FAS66, Footnote 24--Paragraphs 13 and 14 of Opinion 21 provide criteria for selecting an appropriate rate for present-value calculations.

FAS66, Footnote 25--Paragraphs 13 and 14 of Opinion 21 provide criteria for selecting an appropriate rate for present-value calculations.

FAS66, Footnote 26--*Performance* means completion of the improvements required under the sales contract by either the seller or contractors retained by the seller. However, payments made to municipalities or other governmental organizations not under the direct or joint control of the seller constitute performance by the seller if those organizations are not financed solely by liens on property in the project and they undertake to complete the improvements without further risk or obligation of the seller.

FAS66, Footnote 27--Accounting for selling costs is addressed in FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects.*

FAS66, Footnote 28--The financing and interest rate assumptions in this appendix are based on conditions at the time the profit recognition Guide was issued. They should not be considered as indicative of financing and interest rate assumptions that would be appropriate under different circumstances and at different times.

FAS66, Par. 85, Footnote * -- $180,000 equals 95% of gross scheduled rents.

FAS66, Footnote 29—Two-thirds of projected revenue during periods of support of operations; this can also be calculated as projected rental expenses plus projected debt service less projected deficit cash flow.

FAS66, Footnote 30--The financing and interest rate assumptions in these exhibits are based on conditions at the time the profit recognition Guide was issued. They should not be considered as indicative of financing and interest rate assumptions that would be appropriate under different circumstances and at different times.

FAS66, Footnote 31--The term *specialized* is used to refer to those accounting and reporting principles and practices in AICPA Guides and Statements of Position that are neither superseded by nor contained in Accounting Research Bulletins, APB Opinions, FASB Statements, or FASB Interpretations.

FAS66, Footnote 32--Federal and state laws may affect the amount that can be retained by the seller.

FAS66, Footnote 33--An example of a sale of a partnership interest that is in substance a sale of real estate would be an enterprise forming a partnership, arranging for the partnership to acquire the property directly from third parties, and selling an interest in the partnership to investors who then become limited partners.

FAS66, Footnote 34--For purposes of this Statement, a time-sharing interest that is in substance a sale of real estate is the exclusive right to occupy a specified dwelling unit for a designated period each year and represents (a) fee simple ownership of real estate or (b) a right-to-use time-sharing interest that is a sales-type lease as defined in Statement 13, as amended and interpreted.