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American Institute of Certified Public Accountants. Committee on Land Development Companies

An AICPA Industry Accounting Guide

Accounting for Retail Land Sales

AICPA
American Institute of Certified Public Accountants

Notice to Readers

This AICPA industry accounting guide is published for the guidance of members of the Institute in examining and reporting on financial statements of retail land sales companies. It represents the considered opinion of the Committee on Land Development Companies and as such contains the best thought of the profession as to the best practices in this area of financial reporting. Members should be aware that they may be called upon to justify departures from the Committee's recommendations.

This guide has the approval of five of the six members of the Committee, one of whom approves with qualification. Comments of those approving with qualification and disapproving are on page 38.

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The substance of this guide has been reviewed by the Accounting Principles Board (1972-73) of the American Institute of Certified Public Accountants and has been approved for publication by the affirmative vote of fifteen of its eighteen members, two of whom approve with qualification. Comments of those who approve with qualification and disapprove are on page 39.

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Accounting for Retail Land Sales

Prepared by the Committee on Land Development Companies of the
American Institute of Certified Public Accountants

Contents

Introduction

1. The retail land sales industry is one that has gained prominence during the last two decades. The basic characteristic of the industry has been the acquisition by a sales company of large tracts of unimproved land for subdivision into lots for sale to widely dispersed retail customers through intensive marketing programs. One significant aspect of a typical retail land sale is that the lot may ordinarily be purchased with a relatively small down payment. The sales contract[1] (or promissory note) provides that the balance of the purchase price be paid over a long-term period.

2. In some instances, retail land sellers have sold lots in a totally unimproved state; frequently, however, the lots are improved, or are intended to be improved, through the addition of roads, utilities, and offsite "amenities" such as golf courses, recreation centers, and lakes.

3. In April 1970 the newly appointed American Institute of Certified Public Accountants Committee on Land Development Companies, which included practitioners knowledgeable in the industry, commenced a review of the accounting and reporting practices of the retail land sales industry. In carrying out its assignment, the Committee sought the counsel of industry representatives, the financial community, and other interested parties

[1] The term "sales contract" as used herein applies to the agreement between the buyer and seller, whatever its form, and "sales contract receivable" as used herein applies to the receivable due over an extended period of time, whatever its form, usually requiring level monthly payments.

to provide background and comments for consideration. This guide is a result of that review.

Nature of Business Activity

4. The dominant activity of this industry is retail marketing of numerous lots, subdivided from a larger parcel of land, for use by the original or a subsequent purchaser as a primary or secondary homesite or as recreational property for placement of motor homes or other recreational vehicles. That use generally requires improvement of the property with roads; property that is ultimately to be used for homesites also needs water and other utilities as well as site preparation such as grading, creation of waterways, and so forth. Additionally, the projects sometimes require other significant offsite improvements and amenities to provide basic recreational and community facilities and may involve planned unit and community developments. Some of the amenities may be self-supporting and others not; the cost of the latter must be wholly or partially recovered from sales of lots. Planned unit and community developments frequently also involve sales that are not retail lot sales under this guide; for example, sales of commercial and industrial land parcels and bulk sales of lots to builders.

5. Typically, a retail land sales company acquires land, prepares a master plan for subdivision and improvement, obtains requisite governmental and regulatory approvals, undertakes to sell the lots, and performs (or contracts with others to perform) the necessary improvement work. Although financing is sometimes provided to the purchaser by financial institutions and the purchaser takes title at the time of sale, in most instances a substantial portion of the purchase price is financed by a receivable accepted by the seller as part of the consideration. The receivable is usually a land sales contract but occasionally is a purchase money mortgage. The receivable is typically collectible with interest over a number of years; unless the purchaser cancels the contract within a specified refund period, default in payments results in his loss of his interest in the lot and of all payments made. Receivables from retail land sales are sometimes based on the purchasers' personal credit but usually involve no credit investigation or personal credit obligation, and the seller cannot require performance or seek deficiency judgments by operation of law or contract.

6. In many projects,[2] neither purchaser nor seller expects the lot to be used for any purpose until completion of payment, and therefore some or all of the promised improvements are deferred until later in or after the payment period. Occasionally, projects are so remote from existing population centers and recreational areas or so lacking in significant improvement or basic utilities that ultimate use for any purpose except speculation is questionable.

7. Under the wide variety of circumstances described, it is doubtful that any single method of accounting can be appropriate for every project. Accordingly, the Committee has sought to determine the methods that are appropriate to given sets of circumstances and the disclosures that are required for more meaningful financial reporting in the industry.

Applicability

8. This guide applies to retail lot sales on a volume basis with down payments that are less than those required to evaluate collectibility of casual sales of real estate. Wholesale or bulk sales of land and retail sales from projects comprising a small number of lots are subject to the general principles for profit recognition on real estate sales.[3]

9. The Committee recognizes that retail land sales may occur under circumstances that differ substantially from those previously described. The following are attributes of such sales made by some subdividers or developers:

a. The land is sold in an improved state; roads, water, sewers, and other amenities are completed and in place, and the land can be used immediately for construction.

b. The seller gives the purchaser a deed at the time of sale; the purchaser gives the seller a cash down payment of at least 10 percent and a note bearing interest at an appropriate market rate that is legally enforceable against the pur-

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[2] "Project," as used in this guide, refers to a geographic area consisting of homogeneous, reasonably contiguous land which may, for development and marketing purposes, be subdivided in accordance with a master plan.

[3] The AICPA Committee on Accounting for Real Estate Transactions is expected to issue an accounting guide on this subject. An exposure draft of the guide was published in January 1973.

chaser's general credit and is collateralized by a first mortgage on the land. The seller makes credit checks as a regular procedure.

c. The ratio of the loan to the value of the land is low enough that local banks and savings and loan institutions would loan money on the property at similar rates, and it is clearly evident that the purchaser's notes are marketable at banks without substantial discount and without recourse to the seller.

If all of the foregoing conditions exist, many of the specific recommendations for retail land sales companies in this guide do not apply because the earnings process is complete and an exchange at a readily measurable price has taken place.

Timing of Revenue and Income Recognition

10. Statement of the Accounting Principles Board No. 4 (October 1970) describes realization as a pervasive measurement principle as follows:

> P-2. *Realization.* Revenue is generally recognized when both of the following conditions are met:
> (1) the earning process is complete or virtually complete, and
> (2) an exchange has taken place.[4]

Implicit in the realization principle is the assumption that consideration received in the exchange can be valued with reasonable certainty.

11. Statement No. 4 indicates that "unearned revenue"[5] results if money is received or amounts are billed in advance of delivery or performance. Furthermore, revenue is sometimes recognized on bases other than the realization principle, i.e., as the earning process takes place (e.g., long-term construction contracts) or on completion of production (e.g., precious metals or farm products with assured sales prices).[6]

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[4] Statement of the Accounting Principles Board No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises,* October 1970, p. 59.

[5] *Ibid.,* p. 60, para. 153.

[6] *Ibid.,* p. 59, para. 152.

12. The "realization point" indicates the accounting period in which revenue and expenses should be matched to measure the income or loss resulting from the business activity. Costs (other than selling costs) that are incurred in anticipation of revenue should be deferred until the related revenue is recognized. Costs expected to be incurred after the "realization point" ("after costs") must be accrued to properly measure periodic income (loss).

13. The principle of realization presupposes that title will be transferred at or before the time of profit recognition. Delay in conveyance of title may occur in the real estate industry for a variety of reasons and does not require deferring profit recognition for an otherwise acceptable transaction if the purchaser has the right to receive title when the receivable is paid or at the end of the normal contract period. Receipt of option deposits does not constitute a recordable sale under the realization principle.

14. Since a strict application of the realization principle might not provide the most meaningful financial reporting in all cases, certain modifying conventions have been developed. Those modifying conventions are usually applied if the earning process extends over several accounting periods, necessitating a reasonable attempt to measure results of operations in each accounting period. The modifying conventions that apply to retail land sales are described below.

Recording of Sales

15. The characteristics of "sales" in the retail land sales industry—small down payment, unenforceability of the sales contract by the seller, customer refunds within an established cancellation period—require that criteria be established to determine when a sale should be recorded for accounting purposes. The Committee believes that recognition of a sale should be deferred until certain conditions are met that indicate that (a) the customer seriously intends to complete the contract and (b) the company is capable of fulfilling its obligations under the contract so that customers cannot later demand and receive refunds for failure to deliver. Accordingly, contracts should be recorded as sales only when all the following conditions are met:

a. The customer has made the down payment and each regularly required subsequent payment until the period of cancellation with refund has expired. That period should be the longest of the period required by local law, established by company policy, or specified in the contract, regardless of whether refunds are available through simple notification, site visitation, or otherwise.

b. The aggregate payments (including interest) equal or exceed 10 percent of the contract sales price.

c. The selling company is clearly capable of providing both land improvements and offsite facilities promised in the contract and of meeting all other representations it has made. Its current and prospective financial capabilities are sufficient to provide reasonable assurance that it will be able to fund or bond the planned improvements in the project when required. That ability may be demonstrated by the company's adequate equity capitalization, or its borrowing or bonding capacity, or a continuing positive cash flow from operations.

Companies may, of course, establish more restrictive requirements for determining the point at which a sale should be recorded.

16. Until all three conditions are met, monies collected should be recorded as deposits. (See "Deposit Accounting," paragraphs 47 and 48.)

Accounting Method for Recording Income (Accrual vs. Installment)

17. If a sale is recorded, the method of accounting for the income from it depends on the degree to which it is expected that the resultant receivable will be collected in full. Normally, the accrual method of accounting is required for sales transactions in most industries unless the circumstances are such that collection of the sale price is not reasonably assured, in which case "either the installment method or cost recovery method of accounting may be used."[7]

18. Since a customer usually has the option to discontinue payments on a retail land contract at any time, though forfeiting his investment if the refund period has expired, various factors

[7] APB Opinion No. 10, *Omnibus Opinion (Installment Method of Accounting)*, December 1966, para. 12, footnote 8.

that may affect the probability of completing the contract must be considered before the accrual method is deemed acceptable for the project involved.

19. The Committee concludes that usually the choice of an appropriate accounting method should be based on the company's own experience with each individual project. In no instance may industry experience be used. If new projects are started by companies that have demonstrated an ability to develop other projects successfully, the experience with prior projects may be applied to a new project if the prior projects clearly had predominantly the same characteristics (environment, clientele, contract terms, sales methods) as the new project.

20. The accrual method of accounting should be applied to those projects in which collections on contracts are reasonably assured and *all* of the following conditions are met (the installment method must be followed for all other projects—see paragraph 23 and "Installment Method," paragraphs 43-46):

a. The properties clearly will be useful for residential or recreational purposes at the end of the normal payment period. There must be a reasonable expectation that the land can be developed for the purposes represented. For example, it should be expected that local ordinances and other legal restrictions, such as those arising from ecological considerations, 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. (If ultimate utility seems doubtful, contracts entered into for speculative purposes are unlikely to be completed.)

b. The project's improvements have progressed beyond preliminary stages, and there is evidence that the work will be completed according to plan. Ordinarily, the work should have begun, although the existence of engineering plans and work commitments relating to lots sold will demonstrate progress. In the absence of efforts directly related to lots already sold, completion of access roads and amenities such as golf courses, clubs, and swimming pools furnishes evidence of progress. The best evidence of progress and commitment by the company is the expenditure of funds on the proposed improvements. Conversely, there should be no evidence of significant delaying factors such as the inability to obtain permits, obtain contractors, or hire personnel and equipment.

c. The receivable is not subject to subordination to new loans on the property, except that subordination for home construction purposes is permissible provided that collection experience on those contracts is the same as on contracts not subordinated.

d. Collection experience for the project indicates that collectibility of receivable balances is reasonably predictable and that 90 percent of the contracts in force six months *after sales are recorded* (see paragraphs 15, 16, and 27) will be collected in full.[8] The greater the customer's investment at risk of forfeiture, the more likely he will honor his commitment; accordingly, a down payment sufficient to record the sale if it were a casual sale (say, 20-25 percent) is an acceptable substitute for this test of collection experience.

21. The ability to predict the collection results of current sales presumes satisfactory experience on prior sales of the type of land being currently marketed in the project over a sufficiently long collection period to indicate the percentage of sales that will be collected to maturity. Since different sales methods may result in different cancellation and collection experience, historical data available must include experience with respect to each type of sales method used, such as telephone sales, broker sales, site visitation sales, and so forth.

22. Thus, the Committee concludes that income should be recorded under the accrual method if the company's collection experience can provide information (described in paragraph 20(d)) that supports a reasonable prediction of whether the required percentage of contracts will pay out to maturity and all other conditions are met. The Committee believes that condition (d) above is vital to provide assurance that the uncertainties regarding collectibility of the remaining receivables are minimized.

23. Unless all conditions for use of the accrual method are met for the entire project, the installment method should be applied to all recorded sales. At the time that all four conditions are satisfied on a project originally recorded under the installment method, the accrual method of accounting should be adopted for the entire project (current and prior sales) and the effect ac-

[8] The six-month period is a measurement factor designed solely to test eligibility for the accrual method and is not intended to affect the recording of sales.

counted for as a change in accounting estimate due to changed circumstances in accordance with the provisions of APB Opinion No. 20, *Accounting Changes,* paragraphs 31-33. Essential disclosure of the change is the effect on income of the period of change: the impact on income before extraordinary items, net income, and related per share amounts. Components of revenue and costs should be disclosed as supplementary information. (See Exhibit II, Schedules C and D.)

Accrual Method

General Procedures

24. At the time a project meets all the conditions in paragraphs 20-22 for recording income under the accrual method, the following procedures should be applied:

a. The contract price before deduction for that portion applicable to (a) the discount required, if any, through valuation of the receivable (see paragraphs 29-33) and (b) deferred revenue related to improvement work not yet performed (see paragraphs 38-42) should be recorded as gross sales. The portion of the discounted price applicable to future improvements required under the contract should be classified as deferred revenue and recognized as the work is performed.

b. Contracts that are recorded as sales and are cancelled in the same reporting period should be included in and then separately deducted from gross sales or should otherwise be disclosed appropriately.

c. The amount of sales recorded that is not expected to be collected because of cancellation in subsequent periods should be deducted, together with any discount and deferred revenue, from gross sales (with disclosure in the income statement) to derive net sales.[9] (See Exhibit I, Schedule E.) Receivable balances applicable to cancelled contracts should be charged in their entirety to the allowance for contract cancellations.

d. The computation of cost of sales (land and improvement

[9] The net sales recorded should include anticipated receipts from the sales contracts recorded and expected to cancel before maturity.

costs incurred, carrying costs, and so forth) should be based entirely on the net sales thus recorded.

e. The unamortized valuation discount and allowance for contract cancellations should be shown as deductions from the receivables in the balance sheet.

25. Past experience that is the basis of predictions of future collection results should be updated frequently to apply the latest available data to current transactions. Since the net amount recorded is based primarily on historical experience factors, it follows that no specific identification of contracts should be made between those expected to cancel and those expected to pay out to maturity.

26. Accounting for retail land sales involves reporting of a large volume of relatively small individual sales and is conducive to the use of statistical methods to evaluate expectations. Thus, methods that may be appropriate to a retail land seller in estimating collectibility and deciding whether a recordable sale has occurred would be inappropriate for individual transactions, such as bulk sales or isolated sales of larger parcels of land.

Delinquency and Cancellation

27. Evaluating historical data to establish the ability to predict the collection of receivables from current sales requires experience with a representative sample of receivables over an adequate period of time. If receivables in the sample are past due at the end of the period of time selected, the Committee concludes that the receivables should be considered uncollectible and the contracts presumed to be cancelled (for this purpose) if regular payments due are unpaid for the following delinquency periods:

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

28. It is necessary, of course, to continually monitor the adequacy of the allowance for contract cancellations provided for previously recorded sales. The criteria in the preceding paragraph for determining when delinquent receivables are presumed to be uncollectible should be applied to determine whether a current addition is required to an inadequate allowance for contract

cancellations. The specified delinquency periods may be extended for extenuating circumstances if the purchaser has given or is willing to accept personal liability on his debt, provided that his ability to complete payment on the contract can be determined.

Initial Measure of Consideration (see Exhibit I)

Requirements of Generally Accepted Accounting Principles

29. The generally accepted principle of accounting for exchanges is discussed in Statement of the Accounting Principles Board No. 4 as follows:

> M-1A. *Acquisition Costs of Assets.* Assets acquired in exchanges are measured at the exchange price, that is, at acquisition cost. Money and money claims acquired are measured at their face amount or sometimes at their discounted amount. *Discussion.* Cash, accounts receivable, and other short-term money claims are usually measured at their face amount. A long-term noninterest-bearing note receivable is measured at its discounted amount.

30. APB Opinion No. 21, *Interest on Receivables and Payables*, subsequently said (paragraph 13) the following:

> . . . The objective [in determining an appropriate discount rate] is to approximate the rate which would have resulted if an independent borrower and an independent lender had negotiated a similar transaction under comparable terms and conditions with the option to pay the cash price upon purchase or to give a note for the amount of the purchase which bears the prevailing rate of interest to maturity.

This raises the question of the specific value that should be ascribed to a long-term receivable acquired in an exchange if the stated interest rate is less than the then prevailing current rate for an obligation with similar terms, security, and risk. If the receivables are traded in an open market, the market provides the evidence needed to value the asset. If no active market exists for the receivables, the valuation problem is more difficult. And, since cash payments in full at sale date or shortly thereafter are not frequent, no reasonable basis ordinarily exists for determining a cash value.

31. The Committee sought the counsel of industry representatives, of the financial community, and of other interested parties in determining reasonable standards for approximating the present value of receivables from retail land sales.

Determining an Appropriate Interest Rate

32. In determining an appropriate interest rate for use in present value computations, the Committee considered all the guidelines set forth in APB Opinion No. 21. Since neither a public market nor an opportunity for non-recourse discounting generally exists, the valuation of receivables of retail land sales companies must be based on other considerations. One consideration is that retail land sellers generally do not investigate purchasers' credit, but the significance of that fact in determining an interest rate is considerably reduced by deducting an experience-tested allowance for cancellations from the gross receivable. Another consideration is that initial loan-to-value ratios are higher than is usual for loans on real estate, but some recognition should be given to the fact that the collateral (land) supporting the receivable does not depreciate and is readily recoverable, and that extensive facilities for its resale are available. The Committee specifically considered as a possible guideline the current rate of interest at which the purchaser could obtain financing of a similar nature from other sources and finally concluded that a fully comparable lending situation ordinarily does not exist.

33. The Committee believes that generally the credit ratings of retail land purchasers approximate those of users of retail consumer installment credit provided by commercial banks and established retail organizations. Accordingly, the Committee concludes that the effective annual yield on the receivable (without a reduction for deferred revenue or deferred income tax) should not be *less* than the minimum annual rate charged locally by commercial banks and established retail organizations to borrowers financing purchases of consumer personal property with installment credit.[10] In the absence of more definitive criteria, the objective of evaluating the gross receivable less contract cancellation allowance should be to record the net receivable at the value at which it could be sold on a volume basis at the time of the initial transaction without recourse to the seller.

34. No special provision need be made for future accounting

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[10]The rate to be applied should be the one which is used predominantly in installment financing of soft goods and appliances. The Committee believes that for 1972 and recent prior years, a rate of not less than 12 percent is appropriate.

and collection costs because prevailing interest rates can be assumed to compensate for those administrative costs.

Amortization of Discount to Income

35. Valuation discount, if any, should be amortized to income over the life of the contract in a way that results in a constant rate of interest on the amount of the related receivable at the beginning of each period. (See Exhibit I, Schedule B.)

Allowance for Future Discounts

36. Many companies 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 selling company can reasonably be expected to institute those or similar programs in the future, the measurement of initial consideration should be reduced through charges to income for anticipated discounts not otherwise recognized. Reductions that are given or taken sporadically should be charged to income in the period they occur.

Subsequent Revaluations of Consideration

37. Consideration properly valued initially using the approximation techniques discussed in this guide should not be revalued subsequently for reasons other than adjustments related to collectibility or realizability; the latter adjustments would be made by appropriate charges or credits to income at the time collection experience warrants them.

Revenue Related to Future Performance Requirements (see Exhibit I)

38. If a seller is obliged to complete improvements of lots sold or of amenities and other facilities applicable to lots sold, the earning process is not complete if these requirements are significant in relation to total costs and remain unperformed at the time the sale is recorded. The Committee considered various alternative ways to determine the portion of the total revenue (and thus of the ultimate profit) to be recognized as earned by the required performance. No direct means of quantification exists to determine the sales value of the property without the required improvements, and the risks associated with delay in performance and with possible imposition of significant changes in zoning or development requirements by regulatory authorities

make the determination more difficult. Accordingly, the Committee concludes that the amount of revenue recognized (discounted contract price) at the time a sale is recorded should be based on the stage of completion of the required performance. The stage of completion should be measured by the relationship of cost already incurred to total estimated costs to be incurred, including costs of the marketing effort. Under that method, the total revenue will be recognized at the time of recording the sale if performance is virtually complete; if performance is incomplete, the portion of revenue related to costs not yet incurred will be deferred to be recognized as the costs are incurred. Revenue recognized at the time of recording the sale and revenue recognized as performance is subsequently completed should be separately disclosed in the statement of income.[11]

39. Performance relates to the completion of the improvements required under the contract by either the selling organization or contractors retained by the seller, and the act of entering into a contract for performance does not result in revenue recognition. 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.

40. Interest and project carrying costs incurred prior to sale on some projects may have already been charged to expense and would therefore not be included in cost of sales at the time the sale is recorded. Determination of the portion of revenue to be recorded at the time of sale in such cases should recognize costs previously charged to expense by including them in the denominator of the fraction.

41. Adjustments of estimated costs to complete improvements and amenities of a project will not affect previously recorded deferred revenues applicable to future improvements and should not be charged or credited to income of the period in

[11]The Committee considered and rejected the suggestion that revenue for future improvement performance should be calculated using an imputed rate of profit based on the company's experience and pricing policy or on construction industry data. The Committee concluded that fixed price contract commitments for performance several years in the future are not customary and that accounting practices generally do not presently allow imputation of differing profit rates to various elements in the same production and sales process.

which the need for adjustment becomes evident unless the adjusted total exceeds the applicable deferred revenue.[12] If that occurs, the total anticipated loss should be charged to income in the period in which the need for adjustment becomes evident. It should be noted that the need to recognize anticipated losses on lots sold may also raise questions as to the recovery of costs of land and improvements not yet sold.

42. Selling costs directly associated with a project are included in the fraction used to determine revenue earned, thereby increasing the amount of revenue recognized in year of sale. Those costs should, of course, be charged to expense as incurred (except as otherwise provided under "Deposit Accounting," paragraphs 47 and 48). These selling costs are included in the revenue recognition formula because the marketing effort is usually the dominant activity in the retail land sales industry. Selling costs that are identifiable with a project and with obtaining sales contracts are direct costs of a business activity producing identifiable revenue, unlike general selling expenses that are identifiable with a business as a whole or one of its products. For those reasons, selling costs directly identified with lot sales and specific project promotion are deemed to rank with the costs of land and improvement for purposes of allocating revenue.

Installment Method

General Procedure

43. The following procedures should be applied under the installment method of accounting for retail land sales:

a. The entire contract price applicable to the installment sale, without reduction for cancellations or discounts, should be reported as revenue in the income statement of the year the sale is recorded.

b. Cost of sales (including provision for future improvement costs) and selling, general and administrative expenses (ex-

[12] When cost estimates are revised, the relationship of the two elements included in deferred revenue—costs and profit—should be recalculated on a cumulative basis to determine future income recognition as performance takes place.

cept to the extent deferred under (c) below) should be charged to income of the current period.

c. Gross profit less selling costs directly associated with the project (see paragraph 45 below) should be deferred and recognized in income as payments of principal are received on the sales contract receivable. Accordingly, principal payments received will result in the recovery of land and improvement costs and certain selling expenses, and in the recognition of income.

d. Interest income at the stated contract rate should be recorded as income when received.

e. Unamortized deferred profit should be deducted in the balance sheet from contracts receivable being accounted for on the installment method.

f. If income is being recognized on both the installment and the accrual methods, the income statement (or a footnote) should disclose the portion of sales applicable to the installment method, and the balance sheet (or a footnote) should disclose the portion of receivables applicable to the installment method.

g. Cancellation of sales contracts being accounted for on the installment method should be recorded by removing the unpaid receivables from the accounts, restoring recoverable costs to land and improvements, reducing the liability for future improvements applicable to the cancelled contract, and reducing the applicable unamortized deferred profit. An excess of cancelled receivables over recovered costs and applicable unamortized deferred profit (which will represent unrecovered selling costs) should be recognized as a loss in the period of cancellation.

44. The concepts discussed under "Initial Measure of Consideration" (paragraphs 29-37) and "Revenue Related to Future Performance Requirements" (paragraphs 38-42) are equally applicable to the installment method. However, the Committee believes that since the installment method has the effect of recognizing income more evenly over the life of the contract, the application of those concepts to installment accounting would result in undue complications that would not commensurately increase the usefulness of financial statements of typical land sales companies.[13]

[13]The application of these concepts to installment accounting would ordinarily increase amounts of profit recognized in the earlier years.

Deferred Selling Costs

45. Selling costs that are deducted in determining gross profit under the installment method and which are therefore in effect deferred, should be limited to those closely associated with obtaining sales and limited to amounts expected to be recovered from collectible contracts. Accordingly, excess selling costs attributable either to decreases in sales volume or to unproductive sales programs should be charged to current expense or otherwise provided for by an appropriate allowance for losses on cancellation. The productiveness of the efforts in initial sales campaigns for new projects and the ultimate profitability of sales should be evaluated in determining the appropriate portion of selling costs to be deferred. In no event is it appropriate to defer selling costs applicable to cancelled or delinquent contracts.

Change to Accrual Method

46. If changing a project to the accrual method is required (see paragraphs 23-26), the credit to income required by the change should consist of the unamortized deferred profit less (a) discount, if required, on the receivable balances using the appropriate interest rates in effect at times of original sales and (b) the portion of revenue (also discounted) to be deferred for remaining future performance. The computation should be made as of the beginning of the quarter in which the change is made. (See Exhibit II, Schedules C and D.)

Deposit Accounting

47. Until contracts qualify to be recorded as sales (see "Recording of Sales," paragraphs 15 and 16) all collections (including interest)[14] should be recorded as deposits. No amounts may be reflected in revenue until the period has expired during which the customer may cancel and receive a full refund. Selling costs directly associated with the project, including commissions paid to salesmen, should be proportionately deferred until the sale is recorded. When a contract qualifies as a sale under the accrual method, all applicable deferred selling costs should be charged to expense; under the installment method such sales costs are

[14] When deposits are ultimately recorded as sales, the interest portion is credited to income as interest income under either the accrual or installment method of accounting.

deferred as outlined under "Installment Method" (paragraph 43(c)).

48. When a contract is cancelled (with or without refund), unrecoverable deferred selling costs should be charged to expense and deposits forfeited credited to income. Projects that have qualified for the accrual method normally provide sufficient experience to show that the write-off of deferred selling costs on cancellation would be minimal and would be more than offset by the income derived from forfeitures and from contracts that do not cancel. If the installment method is required because of uncertainties of ultimate collection, it may be necessary to provide for unrecoverable deferred selling costs on contracts that may cancel during the deposit period. Care should be taken to avoid excessive deferral of selling costs during the deposit period; the discussion of excessive selling costs (paragraph 45) is equally applicable to deposit accounting.

Future Performance Costs

Initial Quantification

49. The following factors should be considered if estimates of future improvement costs are required under either the accrual or the installment method:

a. Estimated costs of completion should be based on adequate engineering studies, including reasonable provisions for unforeseen costs in accordance with sound cost estimation practices.

b. Provision should be made for anticipated cost inflation generally experienced in the construction industry locally.

c. Provision should be made for unrecoverable costs of offsite improvements, facilities, and amenities (including operating losses of utility operations and recreational and club facilities) and of other support activities to the extent not chargeable to selling costs or expected to be borne by a future purchaser. Estimates of amounts to be recovered from future sale of utility facilities, and so forth, should be discounted to present value as of the date the net unrecoverable costs are recognized.

Subsequent Review of Initial Quantification

50. Deferred revenue of companies using the accrual method includes initial estimates of future improvement costs as well as deferred profit. Estimates of future improvement costs should be reviewed through periodic engineering studies at least annually and appropriate adjustments should be made to current income as discussed under "Accrual Method" (paragraph 41). Adjustments applicable to projects being recorded under the installment method should be made to current period income only to the extent anticipated additional costs exceed the related remaining deferred profit.

Costs to Be Capitalized

General

51. Costs directly related to inventories of unimproved land or to construction required to bring land and improvements to a saleable condition are properly capitalizable until a saleable condition is reached. Those costs would include interest, real estate taxes, and other direct costs incurred during the inventory and improvement periods. Interest is properly capitalizable if it results from (a) loans for which unimproved land or construction in progress is pledged as collateral or (b) other loans if the proceeds are used for improvements or for acquiring unimproved land. The carrying amount of capitalized costs should not exceed net realizable value. Interest not meeting the above criteria, selling expenses (except those deferrable as previously indicated), and general and administrative expenses should be treated as expenses of the period in which incurred.

Amenities

52. Subdivisions frequently contain amenities such as golf courses, club houses, lakes, parks, utilities, and marinas. In accounting for costs of amenities, consideration should be given to their estimated useful lives, the anticipated return from the facility, the effectiveness of the facility as a marketing aid, and the expected date by which the entire project will be sold.

53. All unrecoverable costs incurred in developing amenities that are not expected to provide a return sufficient to recover

costs both of operation and of construction should be charged to cost of sales of the related home sites on a pro rata basis. However, if it can be demonstrated that the amenities are productive selling aids, they should be depreciated over the shorter of the period during which lots of the project are expected to be sold or estimated useful life (after giving effect to the present value of amounts obtainable from future sale or salvage).

Allocation of Costs to Parcels Sold

54. Once costs to be capitalized are determined, a reasonable method is needed to allocate them to projects and parcels. The following methods of allocation are frequently used in practice:

a. Area methods, using square footage, acres, frontage, or other measures based either on simple averaging methods or on some measure of yield differentials (e.g., equivalent lot yield, or geologically influenced factors such as slope and known soil problems).

b. Value methods (gross or net after estimated future improvement costs), using mortgage release prices, estimated selling prices, or appraisals.

c. Specific identification method, if possible and appropriate.

d. Hybrid methods involving elements of two or more of the other methods.

Any reasonable method, consistently applied, that will fairly match costs with related revenues may be used. Since many expenditures are joint costs, the allocation method that will produce the fairest results depends to a large extent on the circumstances of each case. If the nature of the project is such that costs are reasonably identifiable with specific projects, one of the specific allocation methods (area methods, specific identification, or hybrids thereof) may be appropriate, provided that costs deferred to the future do not exceed net realizable value.

55. In view of the various uncertainties relating to retail land sales projects generally, the preferable allocation method in most situations should be based on relative values. The value approach to cost allocation is less likely to result in deferring of losses. As a rule, the most valuable property of the project is the easiest to improve and sell profitably. Allocating a higher proportion of cost to the more valuable property thus reduces the problem of recovery of the remaining investment.

Disclosure

56. The Committee concludes that the following disclosures should be made, in addition to those previously discussed, in financial statements of retail land sales companies, diversified companies with significant retail land sales operations, and investors deriving significant portions of their income from investees engaged in retail land sales operations.

Reporting Changes in Financial Position

57. APB Opinion No. 19, *Reporting Changes in Financial Position,* requires that a statement summarizing the changes in financial position be presented as a basic financial statement for each period for which an income statement is presented. The significance of long-term receivables and the deferral of revenue and income recognition in the financial position of retail land sales companies may lessen the validity of presentations of changes in financial position based on working capital. For that reason, the Committee considers that the required statement should be restricted to the *sources and uses of cash* rather than changes in working capital (see Exhibit III). Also, because of its significance, this information should be provided for all periods presented *whenever* earnings information is reported.

58. However, if working capital is used as the basis for this presentation (for example, in consolidated financial statements of diversified companies), the amount of receivables maturing over periods longer than one year and amounts not expected to be expended within one year for improvements and accrued commissions should be excluded from working capital.

Methods of Income Recognition

59. The methods of income recognition should be clearly disclosed. If two or more projects are under way using different methods, the methods applicable to each project should be disclosed.

Factors Used in Valuation of Consideration

60. Where the initial valuation of the consideration involves discounting, the interest rate(s) used for the year should be disclosed.

Other Disclosures Regarding Receivables

61. Other information regarding receivables should include the following:

a. Maturities of the gross receivables for each of the five years following the date of the financial statements.
b. Policy for recording land sales and cancellation of receivables.
c. Amount of delinquent accounts and the standard for determining delinquency.
d. Weighted average and range of stated interest rates applicable to the receivables.
e. Amounts of contracts not yet recorded as sales and of related receipts.

Land and Improvement Inventories

62. Land and improvement inventories should be classified as unimproved land, land being improved, fully improved land, and land subject to contracts that have not been recorded as sales. In addition, the capitalization policy with respect to amenities and carrying charges and the method of allocating costs to sales (see "Costs to Be Capitalized," paragraphs 51-55) should be disclosed.

Estimated Liability for Improvements

63. The following information should be given for estimated liabilities for improvements:

a. Estimated total cost to improve major areas from which sales are being made and anticipated expenditures for that purpose over each of the five years following the date of the financial statements.
b. Amount of improvements behind schedule and paid-up contracts with delayed conveyance, if any.
c. Manner in which those estimates are determined.
d. Amount of profit deferred to be matched with improvement costs (included in deferred revenue under the accrual method).

Debt Maturities

64. Maturities of long-term debt should be disclosed for each of the five years following the date of the financial statements, and the weighted average and range of interest rates given.

Liabilities Restricted to Specific Assets

65. If long-term debt or other liabilities may be satisfied by relinquishing title to property without exposure to deficiency judgment, the amounts of those liabilities and the assets subject to the liens should be appropriately disclosed. Netting or offsetting of the liabilities against the related assets is not appropriate.

Sources of Income

66. Major categories of sales and related cost of sales should be disclosed separately, e.g., retail lot sales, bulk lot sales, construction sales, and sales of amenities. Also, the extent of sales to brokers, salesmen, and affiliated entities, including joint ventures, should be disclosed. Revenue recognized on the performance of improvement work and related costs should be separately disclosed.

Effective Date and Retroactive Application

67. The provisions of this guide apply to all financial statements for periods ending on and after December 31, 1972, and should be applied retroactively. Because of the significant changes in criteria and methodology required by this guide, prior years' financial statements should be restated to present earnings trends on a comparable basis. Annual reports containing statements applying the provisions of this guide for the first time should include restated income statements for the latest three fiscal years and restated summarized income data for the two years preceding them.

68. In restating prior years' results, the installment method should be applied retroactively to only those projects that *presently* do not meet the new criteria for accrual accounting. However, contracts which by the close of any reporting period had

not qualified as sales pursuant to this guide (see "Recording of Sales," paragraphs 15 and 16) should be accounted for as deposits until the period in which they qualified to be recorded as sales.

EXHIBIT I

Initial Measure of Consideration (Accrual Method)

(Amounts in thousands)

Assumptions:	
Gross sales contracts recorded at Point 0 (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 at Point 0 relative to above sales contracts ($80 + $20)	100
Collections projected (principal amounts) for years 1 through 9	$ 720
Land cost (applicable to sales contracts of $800)	$ 60
Selling expenses at Point 0	$ 300
Future improvement costs (applicable to sales contracts of $800)	$ 120
Minimum annual yield required on contracts receivable	12%
Discount Required:	
Sales contracts receivable at Point 0 (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 Deferred Revenue Applicable to Future Improvements:

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

$$25\% \times \$650\ (\$1{,}000 - \$200 - \$150) = \$163$$

Profit Recognition at Point 0:		
Revenue recognized:	Cash received at Point 0	$ 100
	Present value of balance of sales contracts receivable	570
	(Net sales $820, less discount $150)	670
Less: Deferred revenue applicable to future improvements		163
Net revenue		507
Less: Costs and expenses ($60 + $300)		360
Pre-tax income		$ 147

* It is assumed that experience shows that 90 percent of contracts in force six months after sales are recorded will ultimately be collected in full.

EXHIBIT I
Schedule A

Present Value of Sales Contracts Receivable

(Amounts in thousands)

Year	Receivable Collections: Principal	Receivable Collections: Interest(A)	Annual Collections	Present Value @ 12%
1	$ 62	$ 42	$104	$ 97
2	66	38	104	87
3	70	34	104	77
4	75	29	104	68
5	79	25	104	60
6	84	20	104	53
7	89	15	104	47
8	95	9	104	43
9	100	4	104	38
	$720	$216	$936	$570

(A) Assumes no interest for year 0.

EXHIBIT I
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 (A)
1	$104	$ 24	($ 62)	($ 66)
2	104	24	(66)	(62)
3	104	22	(70)	(56)
4	104	21	(75)	(50)
5	104	19	(79)	(44)
6	104	16	(84)	(36)
7	104	12	(89)	(27)
8	104	8	(95)	(17)
9	104	4	(100)	(8)
	$936	$150	($720)	($366)

(A) Total interest income equals $216 stated interest plus $150 discount, or $366.

EXHIBIT I
Schedule C

Determination of Income Tax Payable
(Amounts in thousands)

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

Year	Principal Receipts	Profit from Installment Sale	Interest Income from Receivable	Selling Expense	Taxable Income (Loss)	Tax Years 1-9	Tax Effect of Loss Carry-forward from Year 0	Net Tax
0	$100 (A)	$ 82 (A)		($300)	($218) (B)			
1	62	48	$42		90	($ 43)	$ 43	
2	66	51	38		89	(43)	43	
3	70	54	34		88	(42)	19	($ 23)
4	75	58	29		87	(42)		(42)
5	79	61	25		86	(41)		(41)
6	84	65	20		85	(41)		(41)
7	89	69	15		84	(40)		(40)
8	95	74	9		83	(40)		(40)
9	100	78	4		82	(40)		(40)
	$820	$640	$216	($300)	$556	($372)	$105	($267)

(A) Profit on land sale computed on installment method as follows:
Gross profit = $800 — $180 = $620

Principal payment × profit margin $\$80 \times \frac{\$620}{\$800}$ =	$62
Forfeited down payments	20
	$82

(B) Carryforward amount is calculated as follows: 48 percent of $218 = $105.

EXHIBIT I
Schedule D

Accrual Method

Illustration of Financial Statement Presentation of Transactions Assumed in Exhibit I

(Amounts in thousands)

Balance Sheets	Year: Beginning of 0	End of 0	1	2	3	4	5	6	7	8	9
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 (A)		—									
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	
Deferred revenue (B)		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

(A) Assumes that all cancellations occurred in year 0 without refunds of down payments.

(B) Assumes that future performance occurred equally in years 6, 7, 8, and 9.

Note: The illustrative statements are not intended to be representative of retail land sales company financial statements since they do not include statement items not considered necessary to illustrate (1) timing of revenue and income recognition and (2) initial measure of consideration.

EXHIBIT I
Schedule E

Accrual Method
Illustration of Financial Statement Presentation of Transactions Assumed in Exhibit I

(Amounts in thousands)

Income Statements	Year 0	1	2	3	4	5	6	7	8	9	Total
Revenues:											
Gross sales	$1,000										$1,000
Less:											
Estimated uncollectible sales	(180)										(180)
Deferred revenue—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

Note: Statement of Sources and Uses of Cash (Exhibit III) should be appended to the income statement and accompany all annual and interim earnings presentations.

EXHIBIT II
Schedule A

Installment Method
Illustration of Financial Statement Presentation
Based on Assumptions in Exhibit I

(Amounts in thousands)

Balance Sheets	Year										
	Beginning of 0	End of 0	1	2	3	4	5	6	7	8	9
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: Deferred profit		(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

EXHIBIT II
Schedule B

Installment Method
Illustration of Financial Statement Presentation
Based on Assumptions in Exhibit I

(Amounts in thousands)

Income Statements	Point of Sale in 0	End of 0	Year 1	2	3	4	5	6	7	8	9	Total
Revenues:												
Sales	$1,000	$1,000										$1,000
Interest income			$42	$38	$34	$29	$25	$20	$15	$ 9	$ 4	216
Deferred profit (1)	(427)	(427)										(427)
Deferred profit recognized (2)			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 (3)	225	225										225
Selling expenses	300	300										300
Loss on cancellations (4)		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

Notes to Exhibit II, Schedule B:

(Amounts in thousands)

(1) Deferred profit computation:

Sales		$1,000
Cost of sales (see Note 3)		(225)
Selling expense		(300)
Profit		$ 475
Percentage		47.5%
Uncollected receivables		$ 900
Profit percentage		47.5%
Deferred profit		$ 427

(2) Deferred profit recognized is 47.5 percent of principal collections.

(3) Costs applicable to *gross* sales contracts:

Land		$ 75
Future development		150
		$225

(4) Loss on cancellations:

Contracts cancelled in Year 0		$ 200
Unpaid balance		$ 180
Costs recovered (credited to cost of sales):		
Land, at cost	$15	
Future development	30	(45)
Deferred profit at 47.5 percent of $180		(85)
Unrecovered selling cost		$ 50

EXHIBIT II
Schedule C

Installment Method Changed to Accrual Method at Beginning of Year 3
Illustration of Financial Statement Presentation
Based on Assumptions in Exhibit I
(Amounts in thousands)

Balance Sheets	Year 0	1	2	3	4	5	6	7	8	9
Assets:										
Cash	$100	$204	$308	$389	$451	$514	$547	$581	$615	$649
Contracts receivable	720	658	592	522	447	368	284	195	100	
Less:										
Deferred profit	(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 (Deferred revenue after Year 2)	$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

EXHIBIT II
Schedule D

Installment Method Changed to Accrual Method at Beginning of Year 3
Illustration of Financial Statement Presentation
Based on Assumptions in Exhibit I

(Amounts in thousands)

Income Statements	Year 0	1	2	3	4	5	6	7	8	9	Total
Revenues:											
Gross sales contracts recorded	$1,000										$1,000
Improvement revenue—prior sales							$41	$41	$41	$40	163
Deferred profit	(427)										(427)
Deferred profit recognized		$29	$31								60
Interest income (1)		42	38	$ 56	$50	$44	36	27	17	8	318
Income resulting from change from installment to accrual method (2) (described fully in notes to financial statements)				137							137
	573	71	69	193	50	44	77	68	58	48	1,251
Costs and expenses:											
Cost of sales	225										225
Improvement costs—prior sales							30	30	30	30	120
Selling expenses	300										300
Loss on cancellations	50										50
	575						30	30	30	30	695
Income (loss) before provision for income taxes	(2)	71	69	193	50	44	47	38	28	18	556
Provision for income taxes:											
Current				23	42	41	41	40	40	40	267
Deferred		33	33	71	(18)	(19)	(19)	(22)	(27)	(32)	
		33	33	94	24	22	22	18	13	8	267
Net income (loss)	($ 2)	$38	$36	$ 99	$26	$22	$25	$20	$15	$10	$ 289

See Notes to Exhibit II, Schedule D, on page 36.

EXHIBIT II
Schedule D
(continued)

Notes to Exhibit II, Schedule D:

(1) Interest at stated rate for Years 1 and 2; 12 percent after change from installment to accrual method.

(2) Computation of effect of change from installment to accrual method:

	(Amounts in thousands)	
Deferred profit under installment method:		
Original	$427	
Recognized in prior years	(60)	
Applicable to cancelled contracts	(85)	$282
Less, Valuation discount required:		
Receivables at beginning of Year 3	592	
Present value of payments due (principal and interest) at 12 percent	(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

EXHIBIT III

Illustration of Format
Statement of Changes in Financial Position
(Applicable to Retail Land Sales Companies)

Statement of Sources and Uses of Cash

Operations:	
Cash received from:	
Collections on contracts receivable (including interest)	
Cash sales of lots	
Down payments on lot sales	
Sales of residential units	
Sales of commercial units	
Other sources	
Cash expended for:	
Land improvement	
Land purchases (including amounts paid on land purchase mortgages)	
Selling expenses	
General and administrative expenses	
Interest expense	
Residential construction	
Commercial construction	
Amenity construction	
Income taxes	
Other uses	
Cash generated from (used in) operations	
Other sources:	
Proceeds from:	
Net short-term borrowings	
Long-term borrowings	
Sales of fixed assets	
Other	
Other uses:	
Repayment of long-term debt	
Acquisition of fixed assets	
Other	
Increase (decrease) in cash	

Note 1: If changes in financial position arise from transactions not involving cash they should be separately disclosed.

Note 2: The use of a format which begins with net income in the determination of cash generated from or used in operations is acceptable, provided that disclosure is made of the sources and uses of cash, with related amounts, accounting for the significant elements of receipts and expenditures during the period, such as land purchases, land improvements, amenity construction, etc.

Comments of Those Who Qualify Their Approval or Who Disapprove the Publication of This Accounting Guide

Committee on Land Development Companies

Mr. Phoenix approves publication with qualification as follows:

He disagrees with the complex mixture of accrual and installment accounting prescribed in the accounting guide for retail land sales companies. He also disagrees with some aspects of the application of each method. Nevertheless, he assents to the publication of the guide because he believes that further delay would be harmful to the industry, the investing public, and the accounting profession.

Mr. Briloff disapproves publication for the following reasons:

"My objections are presented peremptorily and in summary form, as follows:

"1. The guide pays mere lip service to the concepts and accounting principles underlying financial statements, as set forth in the Board's Statement No. 4. It is dragging a red herring when it quotes the Statement's assertions regarding 'Realization' and 'Acquisition Costs of Assets' (to quantify the consideration ostensibly received on the supposed exchange).

"2. The guide blithely, and without justification, asserts the need for modifying conventions. As was most explicitly and cogently asserted by the SEC's Chief Accountant, the installment accounting method would, for this industry, represent good accrual accounting, as well as have a number of practical benefits. This assertion, in which I concur, cuts the ground from under this tinkering with modifying convention.

"3. A logical extension of the guide's proposals would permit the anticipatory recognition of revenue and income to all situations involving programmed sales, e.g., insurance (especially life), subscriptions, and mutual funds. Going beyond these directly apposite situations, there is no logical reason why an accounting firm could not apply this front-end loading of income for itself since it, too, may have 'a large volume of relatively small individual sales (e.g., perennial audits and tax return preparation) and is conducive to the use of statistical methods to evaluate expectations.' Why not there, too, anticipate the next ten or twelve years of revenues and costs (properly discounted, of course)?

"4. The guide provides for a tripartite sequence of accounting alternatives: 'Deposit Accounting,' 'Installment Method, 'Accrual Method.' This is precisely what Dr. Burton had in mind when, writing at the behest of the SEC, he said: 'If the investor feels that the accounting model represents a 'black box' out of which financial statements spring by some unknown, complicated and mysterious process, it is unlikely that he will develop much faith in the model or its end product.'

"5. The guide implicitly permits the 'full consolidation' of the assets and liabilities, revenues and costs of the retail land sales operations into the financial statements of a manufacturing, trading or financial entity. In view of the proposed exotic modifying conventions, such a full consolidation should be proscribed consistent with Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, paragraph 3.

"6. The disclosure standards should require the overt disclosure of the amounts of income being recycled through the restatement process. This will permit the investment community to recognize the amounts of income for which they are paying once again through the P/E process."

Accounting Principles Board

Mr. Halvorson approves publication with qualification as follows:

He believes that the accounting prescribed by the guide is predicated upon and governed by a complex of rigidities which should not be dignified as being accounting principles, and acquiesces to publication only because it has obtained the approval of a two-thirds majority of the admittedly competent and conscientious AICPA committee responsible for its preparation.

Mr. Kessler approves publication with qualification as follows:

He prefers a delay in publication although he recognizes that there is an urgent need to narrow the differences in accounting in the retail land sales industry and to resolve accounting issues as quickly as possible.

He feels that there are many cases in this industry where, because of uncertainties as to completion of the earning process, installment accounting appropriately reflects income. On the other hand, he considers the accrual method appropriate where definitive criteria are met.

He would prefer to see the complexities and subjective determinations in the application of the accrual method clarified and simplified, as well as an alleviation of the time pressures involved in applying the guide to financial statements for the calendar year 1972, all of which could be done by issuing the guide sometime during the first three months of 1973 to become effective for fiscal years ending on or after June 30, 1973.

Mr. Hayes disapproves of the publication of this guide because while he is in agreement with the general concept that some, but not all, transactions of the industry should be accounted for on the installment basis, he believes the guide does not appropriately implement concepts defined in previous Opinions of the Board. First, he believes that in stipulating the minimum annual interest rate charged installment borrowers by commercial banks and established retail organizations as the appropriate minimum interest rate for receivables arising in retail land sale transactions, the guide establishes an erroneous reference point and thus does not appropriately apply APB Opinion No. 21, *Interest on Receivables and Payables*. In so doing, it fails to recognize the complex nature of the receivables and related accountabilities (deferred taxes and liability for future improvements) created in retail land sale transactions and, accordingly, does not properly specify how to evaluate whether a rate of interest stipulated in a transaction represents fair and adequate compensation on the net funds committed by a seller. Contrary to APB Opinion No. 21, it fails to consider the impact on the interest rate of tax consequences to the buyer and seller and fails to provide meaningfully for recognition of differing terms of receivables or other factors that may differ from case to case. Second, he believes that restatement of prior years' financial statements in this instance is inappropriate primarily for the reasons indicated in paragraphs 14(b) and (c) of APB Opinion No. 20, *Accounting Changes*. Third, he believes that the criteria specified in the guide for deciding upon use of the installment method of accounting for sales overlook many factors which will be encountered in practice and should be considered in applying concepts set forth in paragraph 12 of APB Opinion No. 10, *Omnibus Opinion—1966 (Installment Method of Accounting).*

Mr. Norr disapproves publication for the following reasons:

Installment accounting is appropriate where down payments are small, accounts receivable collected over a period of eight or more years, contracts may be cancelled and sales are on a non-recourse basis. The guide blesses front-ending of income on a basis inconsistent with logic and acceptable accounting. Accrual accounting is inappropriate in these circumstances.

Interest rates for typical paper in this industry should be 18 percent, comparable to consumer small loans of similar size.

Down payments and other payments should be substantially higher before a sale is recognized, to be consistent with real estate accounting in essentially the same circumstances.

The guidelines in paragraph 21 on experience with the type of land being sold are entirely too vague. Each project should stand on its own.

The guide has steadfastly refused disclosure of the number of lots sold and houses built, by project, preventing investors from distinguishing land speculations from the creation of real values.

The guide does a disservice to investors. Significant income is recognized before performance and is inconsistent with franchise accounting. The guide is inconsistent with lease accounting which requires a finance lease (sale) to be noncancellable. The guide is inconsistent with real estate accounting. The methodology is abstruse; simplicity is lacking. Weaknesses in accounting theory have facilitated the emergence of a group of stocks. The guide is unworthy of investor confidence.

Installment accounting is appropriate.

Mr. Welsch disapproves publication for the following reasons:

1. Considering the units to which the accounting is to be applied and the number of different "stages" in accounting, there will be a continuing series of *accounting changes* that not only add complexity but may well render all amounts reported meaningless, and in some cases will produce incongruous results.

2. The down payment requirements are too low.

3. The interest rate is apt to be too low.

4. Disclosure of progress and state of development are not required under "Disclosure."

5. Application of the "system" is too complex.

Mr. Welsch prefers the installment method with strict criteria to be met to qualify for the accrual method. Cash flow statement and disclosure of state of development, accounting changes, interest rates, volume of lots sold, and methods of selling should be required in all cases.