

Section 10,240***Statement of Position 78-9
Accounting for Investments in
Real Estate Ventures*****[Proposal to Financial Accounting Standards Board]****AICPA****American Institute of Certified Public Accountants**
1211 Avenue of the Americas, New York, New York 10036 (212) 575-6200

December 29, 1978

Donald J. Kirk, CPA
Chairman
Financial Accounting Standards Board
High Ridge Park
Stamford, Connecticut 06905

Dear Mr. Kirk:

The accompanying statement of position, *Accounting for Investments in Real Estate Ventures*, has been prepared on behalf of the division by the AICPA Committee on Real Estate Accounting and approved by the AICPA Accounting Standards Executive Committee.

The statement presents the division's recommendations on accounting for investments in real estate ventures (corporate joint ventures, general and limited partnerships, and undivided interests). The recommendations are primarily an application of the existing authoritative accounting literature to the specialized accounting problems related to such investments and are intended to narrow the range of alternative practices.

Representatives of the division are available to discuss this proposal with you or your staff at your convenience.

Sincerely,

Arthur R. Wyatt
Chairman
Accounting Standards Division

cc: Securities and Exchange Commission

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NOTE

Statements of Position of the Accounting Standards Division present the conclusions of at least a majority of the Accounting Standards Executive Committee, which is the senior technical body of the AICPA authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*, identifies AICPA Statements of Position as sources of established accounting principles that an AICPA member should consider if the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by this Statement of Position should be used or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances. However, an entity need not change an accounting treatment followed as of March 15, 1992 to the accounting treatment specified in this Statement of Position.

SOP 78-9 is amended by FASB Staff Position SOP 78-9-1, *Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5*. FASB Staff Position 78-9-1 is effective: for general partners of all new partnerships formed, and for existing partnerships for which the partnership agreements are modified, after June 29, 2005; for general partners in all other partnerships, no later than the beginning of first reporting period in fiscal years beginning after December 15, 2005.

Accounting for Investments in Real Estate Ventures

Introduction

.01 Ownership of real estate or real estate development projects by two or more entities may take several forms. The most common forms are as follows:

- a. *A corporate joint venture*—a corporation owned and operated by a small group of ventures to accomplish a mutually beneficial venture or project, as described in paragraph 3 of APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*.
- b. *A general partnership*—an association in which each partner has unlimited liability.
- c. *A limited partnership*—an association in which one or more general partners have unlimited liability and one or more partners have limited liability. A limited partnership is usually managed by the general partner or partners, subject to limitations, if any, imposed by the partnership agreement.
- d. *An undivided interest*—an ownership arrangement in which two or more parties jointly own property, and title is held individually to the extent of each party's interest.

In this statement of position, the terms *real estate venture* and *venture* apply to all of the ownership arrangements described in this paragraph.

.02 These forms of ownership differ in legal form and economic substance, and the authoritative accounting literature dealing with the specialized accounting problems related to such investments is limited. In practice, those accounting problems are dealt with in a variety of ways, and the division believes narrowing the range of those alternative practices is desirable.

.03 This statement of position presents the division's recommendations on accounting for investments in real estate ventures in financial statements prepared in conformity with generally accepted accounting principles. It does not apply to regulated investment companies and other entities that are required to account for investments at quoted market value or fair value.

The Applicability of the Equity Method of Accounting

Corporate Joint Ventures

.04 APB Opinion 18 requires investments in corporate joint ventures to be accounted for by the equity method and includes guidance for applying that method in the financial statements of the investor. That opinion applies to corporate joint ventures created to own or operate real estate projects.

.05 Paragraph 3 of APB Opinion 18 states that "an entity which is a subsidiary of one of the 'joint venturers' is not a corporate joint venture." A subsidiary, according to that opinion, refers to

... a corporation which is controlled, directly or indirectly, by another corporation. The usual condition for control is ownership of a majority (over 50 percent) of the outstanding voting stock. The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other stockholders, or by court decree.

Accordingly, an investment in a corporate subsidiary that is a real estate venture should be accounted for by the investor-parent using the principles applicable to investments in subsidiaries rather than those applicable to investments in corporate joint ventures. Minority shareholders in such a real estate venture should account for their investment using the principles applicable to investments in common stock set forth in APB Opinion 18 or in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. [Revised, April 1996, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

General Partnerships

.06 The staff of the American Institute of Certified Public Accountants issued an interpretation of APB Opinion 18 in November, 1971, which concludes that many of the provisions of APB Opinion 18 are appropriate in accounting for investments in certain unincorporated entities. The division believes that the principal difference, aside from income tax considerations, between corporate joint ventures and general partnerships is that the individual investors in general partnerships usually assume joint and several liability. The division believes, however, that the equity method enables noncontrolling investors in general partnerships to reflect the underlying nature of their investments in those ventures as well as it does for investors in corporate joint ventures. Accordingly, the division believes that investments in noncontrolled real estate general partnerships should be accounted for and reported under the equity method. This recommendation requires the one-line equity method of presentation in both the balance sheet and the statement of income.¹ Paragraph 19 of APB Opinion 18 should be used as a guide in applying the equity method. Investors in general partnerships should provide for income taxes on the profits accrued on their investment in the partnership regardless of the tax basis used in the partnership return. Differences between the investor's tax basis of the investment and the reported amount of the investment in the financial statements of the investor that will result in taxable or deductible amounts in future years (temporary differences) should

¹ Pro rata consolidation is not appropriate except in the limited circumstances described in paragraph .11.

be accounted for in conformity with FASB Statement No. 109, *Accounting for Income Taxes*. [Revised, April 1996, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.07 The division believes a general partnership that is controlled, directly or indirectly, by an investor is, in substance, a subsidiary of the investor. APB Opinion No. 18 states that the usual condition for control of a corporation is ownership of a majority (over 50 percent) of the outstanding voting stock. However, if partnership voting interests are not clearly indicated, a condition that would usually indicate control is ownership of a majority (over 50 percent) of the financial interests in profits or losses (see paragraph .25). The power to control may also exist with a lesser percentage of ownership, for example, by contract, lease, agreement with other partners, or by court decree. On the other hand, the majority interest holder may not control the entity if one or more of the other partners have substantive participating rights that permit those other partners to effectively participate in significant decisions that would be expected to be made in the ordinary course of business. The determination of whether the rights of the other partners are substantive participating rights should be evaluated in accordance with the guidance for “substantive participating rights” in EITF Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights*. If the other partners have substantive participating rights, the presumption of control by the majority interest holder is overcome. The division believes that a controlling investor should account for its investment under the principles of accounting applicable to investments in subsidiaries. Accordingly, intercompany profits and losses on assets remaining within the group should be eliminated. A noncontrolling investor in a general partnership should account for its investment by the equity method and should be guided by the provisions of paragraph 19 of APB Opinion No. 18 as amended. [Revised, June 2004, to reflect conforming changes necessary due to the issuance of FASB Statement No. 144. As amended, effective: for general partners of all new partnerships formed, and for existing partnerships for which the partnership agreements are modified, after June 29, 2005; for general partners in all other partnerships, no later than the beginning of first reporting period in fiscal years beginning after December 15, 2005, by FASB Staff Position SOP 78-9-1.]

Limited Partnerships

.08 The division believes that the accounting recommendations for use of the equity method of accounting for investments in general partnerships are generally appropriate for accounting by limited partners for their investments in limited partnerships. A limited partner's interest may be so minor that the limited partner may have virtually no influence over partnership operating and financial policies. Such a limited partner is, in substance, in the same position with respect to the investment as an investor that owns a minor common stock interest in a corporation, and, accordingly, accounting for the investment using the cost method may be appropriate. Under the cost method, income recognized by the investor is limited to distributions received, except that distributions that exceed the investor's share of earnings after the date of the investment are applied to reduce the carrying value of the investment. Differences between the investor's tax basis of the investment and the reported amount of the investment in the financial statements of the investor that will result in taxable or deductible amounts in future years (temporary differences) should be accounted for in conformity with FASB Statement No. 109, *Accounting for Income Taxes*. [Revised, April 1996, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

.09 The rights and obligations of the general partners in a limited partnership are different from those of the limited partners and, accordingly, the general partners should be presumed to control the limited partnership. However, the rights of the limited partners may overcome that presumption of control. The guidance in EITF Issue No. 04-5 should be used to determine whether the rights of the limited partners overcome the presumption of control by the general partners. If the presumption of control by the general partners is overcome by the rights of the limited partners, the general partners should apply the equity method of accounting to their interests. If the presumption of control by the general partners is not overcome by the rights of the limited partners and no single general partner controls the limited partnership, the general partners should apply the equity method of accounting to their interests. If the presumption of control is not overcome by the rights of the limited partners and a single general partner controls the limited partnership, that general partner should consolidate the limited partnership and apply the principles of accounting applicable for investments in subsidiaries. [As amended, effective: for general partners of all new partnerships formed, and for existing partnerships for which the partnership agreements are modified, after June 29, 2005; for general partners in all other partnerships, no later than the beginning of first reporting period in fiscal years beginning after December 15, 2005, by FASB Staff Position SOP 78-9-1.]

.10 The division believes that if the substance of the partnership arrangement is such that the general partners are not in control of the major operating and financial policies of the partnership, a limited partner may be in control. An example could be a limited partner holding over 50 percent of the total partnership interest. A controlling limited partner should be guided in accounting for its investment by the principles for investments in subsidiaries. Noncontrolling limited partners should account for their investments by the equity method and should be guided by the provisions of paragraph 19 of APB Opinion 18, as discussed in paragraphs .06 and .07, or by the cost method, as discussed in paragraph .08, as appropriate.

Undivided Interests

.11 In an interpretation of APB Opinion 18 issued by the staff of the American Institute of Certified Public Accountants in November, 1971, the staff concluded that most of the provisions of paragraph 19 of APB Opinion 18 generally would be appropriate in accounting for partnerships and unincorporated ventures, but that if

... the investor-venturer owns an undivided interest in each asset and is proportionately (i.e., severally) liable for its share of each liability, the provisions of the equity method set forth in paragraph 19(c) of the Opinion may not apply in some industries. For example, where it is the established industry practice ... , the investor-venturer may account in its financial statements for its *pro rata* share of the assets, liabilities, revenues, and expenses of the venture.

If real property owned by undivided interests is subject to joint control by the owners, the division believes that investor-venturers should not present their investments by accounting for their *pro rata* share of the assets, liabilities, revenues, and expenses of the ventures. Such property is subject to joint control if decisions regarding the financing, development, sale, or operations require the approval of two or more of the owners. Most real estate ventures with ownership in the form of undivided interests are subject to some level of joint control. Accordingly, the division believes that such investments should be presented in the same manner as investments in noncontrolled partnerships.

If, however, the approval of two or more of the owners is not required for decisions regarding the financing, development, sale, or operations of real estate owned and each investor is entitled to only its pro rata share of income, is responsible to pay only its pro rata share of expenses, and is severally liable only for indebtedness it incurs in connection with its interest in the property, the investment may be presented by recording the undivided interest in the assets, liabilities, revenue, and expenses of the venture.

General Matters

Disclosure

.12 The division believes that investors in real estate ventures should be guided by the provisions of paragraph 20 of APB Opinion 18 in determining the disclosures to be made in their financial statements.

Statement of Cash Flows

.13 FASB Statement No. 95, *Statement of Cash Flows*, governs the form and content of statements of cash flows. [Revised, April 1996, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Investor Accounting for Losses

General

.14 Some investors have suggested that their equity in losses of a real estate venture need not be recorded under the equity method of accounting as long as the value of their investment has not been impaired; for example, if it is expected that the venture's assets can be sold for more than their carrying value. The division believes that investors should record their share of the real estate venture's losses, determined in conformity with generally accepted accounting principles, without regard to unrealized increases in the estimated fair value of the venture's assets.

Accounting for an Investor's Share of Losses in Excess of Its Investment, Including Loans and Advances

.15 The division believes that an investor that is liable for the obligations of the venture or is otherwise committed to provide additional financial support to the venture should record its equity in real estate venture losses in excess of its investment, including loans and advances.² The following are examples of such circumstances:

- a. The investor has a legal obligation as a guarantor or general partner.
- b. The investor has indicated a commitment, based on considerations such as business reputation, intercompany relationships, or credit standing, to provide additional financial support. Such a commitment might be indicated by previous support provided by the investor or statements by the investor to other investors or third parties of the investor's intention to provide support.

.16 An investor in a real estate venture should report its recorded share of losses in excess of its investment, including loans and advances, as a liability in its financial statements.

² An investor, though not liable or otherwise committed to provide additional financial support, should provide for losses in excess of investment when the imminent return to profitable operations by the venture appears to be assured. For example, a material nonrecurring loss of an isolated nature, or start-up losses, may reduce an investment below zero through the underlying profitable pattern of an investee is unimpaired.

.17 If an investor does not recognize venture losses in excess of its investment, loans, and advances and the venture subsequently reports net income, the investor should resume applying the equity method only after its share of such net income equals the share of net losses not recognized during the period in which equity accounting was suspended.

.18 If it is probable that one or more investors cannot bear their share of losses, the remaining investors should record their proportionate shares of venture losses otherwise allocable to investors considered unable to bear their share of losses.³ When the venture subsequently reports income, those remaining investors should record their proportionate share of the venture's net income otherwise allocable to investors considered unable to bear their share of losses until such income equals the excess losses they previously recorded. The division also believes that an investor who is deemed by other investors to be unable to bear its share of losses should continue to record its contractual share of losses unless it is relieved from the obligation to make payment by agreement or operation of law.

.19 The division believes that the accounting by an investor for losses otherwise allocable to other investors should be governed by the provisions of FASB Statement No. 5 relating to loss contingencies. Accordingly, the investor should record a proportionate share of the losses otherwise allocable to other investors if it is probable that they will not bear their share. In this connection, the division believes that each investor should look primarily to the fair value of the other investors' interests in the venture and the extent to which the venture's debt is nonrecourse in evaluating their ability and willingness to bear their allocable share of losses.⁴ However, there may be satisfactory alternative evidence of an ability and willingness of other investors to bear their allocable share of losses. Such evidence might be, for example, that those investors previously made loans or contributions to support cash deficits, possess satisfactory financial standing (as may be evidenced by satisfactory credit ratings), or have provided adequately collateralized guarantees.

Loss in Value of an Investment, Including Loans and Advances, Other Than a Temporary Decline

.20 A loss in value of an investment other than a temporary decline should be recognized. Such a loss in value may be indicated, for example, by a decision by other investors to cease providing support or reduce their financial commitment to the venture. Loans and advances should be evaluated under FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*. [Revised, April 1996, to reflect conforming changes necessary due to the issuance of recent authoritative literature.]

Other Accounting Matters Related to the Use of the Equity Method

Eliminating Interentity Profits and Losses

.21 As noted elsewhere in this statement, APB Opinion 18 should be used as a guide when applying the equity method. Paragraph 19(a) of that opinion provides that, in applying the equity method, intercompany profits and losses should be eliminated until realized by the investor or investee as if the investee

³ This recommendation does not apply for real property jointly owned and operated as undivided interests in assets if the claims or liens of investor's creditors are limited to investors' respective interests in such property.

⁴ An investor may not be able to apply the general rule to an investment in an undivided interest because the extent to which the interests of other investors are encumbered by liens may not be known.

company were consolidated. The division believes that intercompany profit should be eliminated by the investor in relation to the investor's ownership interest in the investee, except that an investor that controls the investee and enters into a transaction with the investee should eliminate all of the intercompany profit on assets remaining within the group.

.22 AICPA industry accounting guide, *Accounting for Profit Recognition on Sales of Real Estate*,* sets out similar rules in paragraph 58:

A sale of property in which the seller holds or acquires an equity interest in the buyer should result in recognizing only the part of the profit proportionate to the outside interest in the buyer. No profit should be recognized if the seller controls the buyer . . . until realized from transactions with outside parties through sale or operations of the property.

.23 The division believes that if a transaction with a real estate venture confirms that there has been a loss in the value of the asset sold that is other than temporary and that has not been recognized previously, the loss should be recognized on the books of the transferor.

Accounting Principles Used by the Venture

.24 In the real estate industry, the accounts of a venture may reflect accounting practices, such as those used to prepare tax basis data for investors, that vary from generally accepted accounting principles. If the financial statements of the investor are to be prepared in conformity with generally accepted accounting principles, such variances that are material should be eliminated in applying the equity method.

Allocation Ratios for the Determination of Investor Income

.25 Venture agreements may designate different allocations among the investors of the venture's (a) profits and losses, (b) specified costs and expenses, (c) distributions of cash from operations, and (d) distributions of cash proceeds from liquidation. Such agreements may also provide for changes in the allocations at specified times or on the occurrence of specified events. Accounting by the investors for their equity in the venture's earnings under such agreements requires careful consideration of substance over form and consideration of underlying values as discussed in paragraph .19. The division believes that in order to determine the investor's share of venture net income or loss, such agreements or arrangements should be analyzed to determine how an increase or decrease in net assets of the venture (determined in conformity with generally accepted accounting principles) will affect cash payments to the investor over the life of the venture and on its liquidation. The division believes that specified profit and loss allocation ratios should not be used to determine an investor's equity in venture earnings if the allocation of cash distributions and liquidating distributions are determined on some other basis. For example, if a venture agreement between two investors purports to allocate all depreciation expense to one investor and to allocate all other revenues and expenses equally, but further provides that irrespective of such allocations, distributions to the investors will be made simultaneously and divided equally between them, there is no substance to the purported allocation of depreciation expense.

* The Financial Accounting Standards Board has extracted the specialized accounting and reporting principles and practices contained in this AICPA Accounting Guide, see FASB Statement No. 66, *Accounting for Sales of Real Estate*, October 1982.

Accounting for a Difference Between the Carrying Amount of an Investment in a Real Estate Venture and the Underlying Equity in Net Assets

.26 Differences between the carrying amount of an investment in a real estate venture and the investor's equity in the underlying net assets recorded by the venture may arise, for example, from unrecognized profit on transfers of real estate to the venture or differences in accounting methods. In addition, differences may arise from the acquisition of an investment in a venture at a price different from the investor's share of the net assets as recorded on the books of the venture.

.27 Differences that arise from a business combination with a venture accounted for as a purchase should be accounted for in accordance with the provisions of FASB Statement No. 141, *Business Combinations*.[†] Paragraph 35 of FASB Statement No. 141 states that the acquiring entity should allocate the cost of an acquired entity to the assets acquired, including intangible assets, and liabilities assumed based on their estimated fair values at date of acquisition.^{*} The division believes that an excess of the cost of the investment acquired over the equity in the underlying net assets usually would be ascribed to the fair values of real property interest owned by the venture. However, any excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed should be recognized as goodwill and should not be amortized.^{||} [Revised, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement Nos. 141 and 142.]

.28 Paragraph 19(b) of APB Opinion No. 18, as amended by paragraph 40 of FASB Statement No. 142, provides that the difference between the cost of an investment and the amount of the underlying equity in net assets of the investee "should affect the determination of the amount of the investor's share of earnings or losses of an investee as if the investee were a consolidated subsidiary." The differences, other than goodwill, should be recognized by the investor as an adjustment to the amount of the venturer's depreciation, cost of sales, or other expenses, as appropriate, in recording income or loss from the venture on the equity basis. Paragraph 40 of FASB Statement No. 142 states that the portion of the difference between the cost of an investment and the amount of underlying equity in net assets of an equity method investee that is recognized as goodwill (equity method goodwill) should not be amortized. However, equity method goodwill should not be tested for impairment in accordance with FASB Statement No. 142. Equity method investments should continue to be reviewed for impairment in accordance with paragraph 19(h) of APB Opinion No. 18, as amended by FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. [Revised, March 2003, to

[†] FASB Statement No. 141, *Business Combinations*, supersedes APB Opinion 16. Effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 31, 2008, the guidance in FASB Statement No. 141 (revised 2007), *Business Combinations*, should be applied. [Footnote added, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement No. 141. Footnote revised, May 2008, due to the issuance of FASB Statement No. 141(R).]

^{*} Paragraphs 35–39 of FASB Statement No. 141 provide guidance on the recognition of assets, including intangible assets, and liabilities apart from goodwill. Effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 31, 2008, the guidance in FASB Statement No. 141 (revised 2007) should be applied. [Footnote added, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement No. 141. Footnote revised, May 2008, due to the issuance of FASB Statement No. 141(R).]

^{||} Paragraphs 12–14 of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, provide guidance on intangible assets subject to amortization. [Footnote added, March 2003, to reflect conforming changes necessary due to the issuance of FASB Statement No. 142.]

reflect conforming changes necessary due to the issuance of FASB Statement No. 142. Revised, June 2004, to reflect conforming changes necessary due to the issuance of FASB Statement No. 144.]

Accounting by the Investor for Certain Transactions With a Real Estate Venture

Capital Contributions

.29 *Contribution of Cash.* If all investors contribute cash at the formation of the real estate venture, each investor should record its investment at the amount of the cash contributed.

.30 *Contribution of Real Estate.* The division believes an investor that contributes real estate to the capital of a real estate venture generally should record its investment in the venture at the investor's cost (less related depreciation and valuation allowances) of the real estate contributed, regardless of whether the other investors contribute cash, property, or services. The division believes that an investor should not recognize profit on a transaction that in economic substance is a contribution to the capital of an entity, because a contribution to the capital of an entity is not the culmination of the earnings process. The division understands, however, that some transactions, structured in the form of capital contributions, may in economic substance be sales. The recommendations in paragraph .36 of this statement on accounting for sales of real estate to a venture by an investor apply to those transactions. An example of such a transaction is one in which investor *A* contributes to a venture real estate with a fair value of \$2,000 and investor *B* contributes cash in the amount of \$1,000 which is immediately withdrawn by investor *A*, and, following such contributions and withdrawals, each investor has a 50 percent interest in the venture (the only asset of which is the real estate). Assuming investor *A* is not committed to reinvest the \$1,000 in the venture, the substance of this transaction is a sale by investor *A* of a one-half interest in the real estate in exchange for cash. A minority of the division disagrees with the conclusion that an investor contributing real estate to a real estate venture should record its investment at the cost of the real estate contributed. They believe that profit recognition by such an investor to the extent of the other investors' interests in the profits and losses of the venture may be appropriate if the other investors contribute cash or other hard assets (such as marketable securities) for their interests and the investor contributing the real estate has no continuing involvement with the real estate that would require deferral of profit under the AICPA industry accounting guide, *Accounting for Profit Recognition on Sales of Real Estate*.[#] The majority of the division believes that unless the investor that contributes real estate to the venture withdraws cash (or other hard assets) and has no commitment to reinvest, such a transaction is not the culmination of an earnings process.

.31 An investor contributing property to a venture may obtain a disproportionately small interest in the venture based on a comparison of the carrying amount of the property with the cash contributed by the other investors. That situation might indicate that the investor contributing the property has suffered a loss that should be recognized.

[#] The Financial Accounting Standards Board has extracted the specialized accounting and reporting principles and practices contained in this AICPA Accounting Guide, see FASB Statement No. 66, *Accounting for Sales of Real Estate*, October 1982.

.32 *Contribution of Services or Intangibles.*** The division believes the accounting considerations that apply to real property contributed to a partnership or joint venture also apply to contributions of services or intangibles. The investor's cost of such services or intangibles to be allocated to the cost of the investment should be determined by the investor in the same manner as for an investment in a wholly owned real estate project.

Income From Loans or Advances to a Venture

.33 Interest on loans and advances that are in substance capital contributions (for example, if all the investors are required to make loans and advances proportionate to their equity interests) should be accounted for as distributions rather than as interest income by the investors.

.34 An investor-lender that does not capitalize interest on its own real estate construction and development projects should account for interest on loans and advances that are not in substance capital contributions in accordance with the recommendations in this paragraph.

- a. All interest income on the investor's loans or advances to the venture should be deferred if either of the following conditions is present.
 - (i) Collectibility of the principal or interest is in doubt. This condition may exist if adequate collateral and other terms normally required by an independent lender are not present.
 - (ii) There is a reasonable expectation that the other investors will not bear their shares of losses, resulting in uncertainty as to the lender's share of the venture's related interest expense.
- b. If neither of the conditions in (a) is present and either the venture has recorded interest as an expense or the venture has capitalized the interest but in order to conform to the investor's accounting policies, the investor has recorded its equity in the income or loss of the venture as if the venture had charged the interest to expense, the entire interest income accrued on loans or advances to a venture should be recorded as earned.
- c. If the conditions in (a) or (b) are not present, a portion of interest income from loans and advances to a venture should be deferred based on the investor's percentage interest in the profits and losses of the venture. However, an evaluation similar to that discussed in paragraphs .18 and .19 for recording the investor's share of losses should be made to avoid recording as interest income amounts that may ultimately be borne as losses by the investor making the loan.

[.35] [Effectively superseded by FASB Statement No. 34, *Capitalization of Interest Cost*, effective for fiscal years beginning after December 15, 1979.]

Sales of Real Estate to a Venture

.36 Sales of real estate by an investor to a real estate venture are subject to all of the provisions set forth in the AICPA industry accounting guide, *Accounting for Profit Recognition on Sales of Real Estate*.[#]

** The provisions of this paragraph do not apply to real estate syndication activities in which the syndicators receive or retain partnership interests. Such activities are discussed in SOP 92-1, *Accounting for Real Estate Syndication Income* [section 10,500].

[#] The Financial Accounting Standards Board has extracted the specialized accounting and reporting principles and practices contained in this AICPA Accounting Guide, see FASB Statement No. 66, *Accounting for Sales of Real Estate*, October 1982.

Sales of Services to a Venture

.37 If services are performed for a venture by an investor and their cost is capitalized by the venture, profit may be recognized by the investor to the extent attributable to the outside interests in the venture if the following conditions are met:

- a. The substance of the transaction does not significantly differ from its form.
- b. There are no substantial uncertainties about the ability of the investor to complete performance (as may be the case if the investor lacks experience in the business of the venture) or the total cost of services to be rendered.
- c. There is a reasonable expectation that the other investors will bear their share of losses, if any.

The method of recognizing income from services rendered should be consistent with the method followed for services performed for unrelated parties.

Purchases of Real Estate or Services From a Venture

.38 An investor should not record as income its equity in the venture's profit from a sale of real estate to that investor; the investor's share of such profit should be recorded as a reduction in the carrying amount of the purchased real estate and recognized as income on a pro rata basis as the real estate is depreciated or when it is sold to a third party. Similarly, if a venture performs services for an investor and the cost of those services is capitalized by the investor, the investor's share of the venture's profit in the transaction should be recorded as a reduction in the carrying amount of the capitalized cost.

Accounting for the Sale of an Interest in a Real Estate Venture

.39 The division believes that a sale of an investment in a real estate venture (including the sale of stock in a corporate real estate venture) is the equivalent of a sale of an interest in the underlying real estate and should be evaluated under the guidelines set forth in the AICPA industry accounting guide, *Accounting for Profit Recognition on Sales of Real Estate*.[#]

[**.40**] [Effectively superseded by FASB Statement No. 66, *Accounting for Sales of Real Estate*, effective for real estate sales transactions entered into after December 31, 1982.]

Transition

.41 The division recommends applying this statement of position to financial statements issued for fiscal years and interim periods beginning after December 24, 1978. Adjustments resulting from a change in accounting method to comply with the recommendations in this statement should be applied retroactively, if material, and, to enhance comparability between periods, financial statements presented for the periods affected should be restated for as many periods as is practicable to give retroactive effect to such adjustments and to changes in presentation. The division encourages earlier application of

[#] The Financial Accounting Standards Board has extracted the specialized accounting and reporting principles and practices contained in this AICPA Accounting Guide, see FASB Statement No. 66, *Accounting for Sales of Real Estate*, October 1982.

the recommendations in this statement for fiscal years beginning before December 25, 1978, in financial statements not previously issued.

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