

# BASICS OF ACCOUNTING FOR REAL ESTATE COMPANIES

To better manage their budgets, forecast financial outcomes, and provide transparency to investors and stakeholders.

Understanding these distinctions is crucial for accurately reporting financial health and ensuring compliance with accounting standards.

Acquisition costs refer to the expenses incurred to obtain a real estate property. These typically include the purchase price, legal fees, and any initial costs necessary to complete the transaction, such as taxes or commissions.

On the other hand, production costs are associated with the development or improvement of a property. This includes costs for construction, materials, labor, and any other expenses necessary to make the property ready for its intended use.

Proper allocation of these costs ensures that the financial statements accurately reflect the company's operations and asset values, which is essential for making informed business decisions.

## Legal basis of accounting for real estate companies

These include the Commercial Code (Handelsgesetzbuch or HGB), which outlines the fundamental principles of accounting, and the International Financial Reporting Standards (IFRS), which may be used by publicly traded companies. These regulations ensure that financial reporting is consistent, transparent, and provides a true and fair view of a company's financial position. Real estate companies, in particular, need to adhere to these standards to accurately reflect their asset valuations, revenue recognition, and cost allocations.

## Commercial Code (HGB)

The HGB forms the central legal basis for accounting obligations. According to Section 238 of the HGB, every businessman is obliged to keep books, from which business transactions can be traced. For capital companies such as GmbH or stock corporations, further regulations apply (Sections 264 ff. of the HGB).

## Importance for Real Estate Firms

These financial statements serve as a critical tool for analyzing a company's financial performance and position, providing insights into aspects such as liquidity, profitability, and solvency.

The balance sheet offers a snapshot of the company's assets, liabilities, and equity at a specific point in time, helping stakeholders understand the resources available to the company and the obligations it must fulfill. The profit and loss statement, on the other hand, summarizes the revenues, expenses, and profits or losses over a reporting period, giving a detailed view of the company's operational efficiency and financial results.

The appendix to the financial statements provides additional information and context, such as accounting policies, detailed breakdowns of certain expenses, and explanations of significant financial events. This supplementary information is essential for a comprehensive understanding of the company's financial health and for making informed investment and management decisions.

Adhering to these regulations not only ensures compliance but also enhances the credibility of the financial statements, ultimately fostering trust among investors, lenders, and other stakeholders.

## Tax Code (AO)

The AO sets out the tax accounting obligations in Sections 140 and 141. Companies that are required to keep accounts under other laws must adjust their tax accounting accordingly.

## Income Tax Act (EStG)

The EStG stipulates how income and expenses are to be taken into account in taxation (Section 4 Paragraphs 1 and 3 of the EStG). The distinction between operating expenses and acquisition/production costs plays an important role here.

## Principles of proper accounting (GoB)

The GoB are binding rules that are derived from case law and general commercial principles. Among other things, they require the completeness, accuracy and verifiability of the accounting.

### 1. Acquisition costs

Acquisition costs are all expenses that are incurred in order to acquire an asset (e.g. a property) and to put it into an operational state (Section 255, Paragraph 1 of the German Commercial Code).

- Purchase price
- Notary fees
- Property transfer tax

### 2. Production costs

Production costs include all expenses that are required to produce, expand or significantly improve an asset (Section 255, Paragraph 2 of the German Commercial Code).

- Construction costs
- Material costs
- Labor costs