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FASB proposal

Accounting for joint venture formations to be clarified

October 28, 2022

Proposed ASU would require a joint venture formation transaction to be measured at fair value.

Source and applicability

- Proposed ASU, Business Combinations – Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement
- The separate financial statements of newly formed and existing joint ventures (JVs)

Fast facts, impacts, actions

The proposed ASU would introduce Subtopic 805-60, containing new accounting requirements for the formation of a JV. These requirements would apply to the separate financial statements of an entity that meets the US GAAP definition of a JV (or a corporate JV).

The proposed ASU would resolve current diversity in practice by specifying how net assets contributed to a JV would be accounted for on the JV's formation. JVs would be required to:

- recognize a new basis of accounting for contributed net assets as of the formation date;
- measure the contributed identifiable net assets at fair value on the formation date using the business combination guidance in Subtopic 805-20 (with certain exceptions), regardless of whether a venturer contributes a business;
- measure the net assets' fair value based on 100% of the JV's equity immediately following formation;
- record goodwill (or an equity adjustment, if negative) for the difference between the fair value of the JV's equity and its net assets;
- provide disclosures about the nature and financial effect of the formation transaction.

The proposed ASU would allow existing JVs to apply the guidance retrospectively. Therefore, if a JV had used carryover basis to measure its net assets on formation, it would have the option to retrospectively adjust the basis of those net assets under new Subtopic 805-60.

What the proposed ASU would not do: It would not amend the definition of a JV, the accounting by a venturer for its investment in a JV, or the accounting by a JV for contributions received after its formation.

Stakeholders have until December 27, 2022 to comment on the proposed ASU. The proposed amendments will become US GAAP only if and when the FASB issues a final ASU.

Background

Currently, US GAAP does not provide guidance on how a JV should initially recognize and measure net assets contributed upon formation. In fact, JV formation transactions are explicitly scoped out of Topic 805 (business combinations) − even when two existing business are combined − and Topic 845 (nonmonetary transactions). This lack of guidance has led to diversity in practice, with some JVs initially measuring their net assets at carryover basis and others at fair value.

The proposed ASU would resolve this diversity in practice by creating Subtopic 850-60 to address the accounting treatment of JV formations. However, it would not amend the accounting by a venturer for its investment in a JV, or the accounting by a JV for contributions received after its formation. It also would not amend the definition of a JV, which is currently contained in the ASC Master Glossary.

The scope of Subtopic 850-60 would be limited to entities that meet the definition of a JV (or corporate JV). In practice, the definition can be challenging to apply because it includes qualitative characteristics beyond joint control. In fact, the SEC staff have objected to a conclusion that joint control is the only defining characteristic of a JV.

A new basis of accounting

Under the proposed ASU, a JV formation would trigger a new basis of accounting, requiring net assets contributed to the JV in a formation transaction to be measured at fair value at the formation date.

The proposed ASU does not define a JV formation. It is unclear whether the proposed ASU only applies to newly formed legal entities or could also include transactions where a new venturer obtains an interest in an existing entity. Entities would need to apply judgment to identify a formation transaction.

Formation date

A JV would apply the new basis of accounting on the formation date. This date is the date the entity initially meets the definition of a JV, which is not necessarily the same as the legal entity's formation date. The formation date is meant to function like the acquisition date in a business combination.

The proposed ASU would provide guidance on whether to combine two or more transactions into a single formation transaction. When multiple transactions are combined those contributions would be measured at their formation date fair value but ultimately would be recognized only when they have satisfied the recognition criteria in Subtopic 805-20. This proposed guidance is consistent with the guidance in Subtopic 810-10 on combining multiple transactions for the sale or derecognition of a business.

In addition, the proposed ASU would require entities to identify transactions that, while included in the contractual arrangement, are to be accounted for separately from the formation transaction. Entities would do so by applying existing guidance in Topic 805 on identifying transactions separate from a business combination.

The proposed ASU would apply only to initial formation transactions. Other US GAAP would apply to subsequent contributions, which could be accounted for differently (e.g. under an asset acquisition model). Therefore, JVs may need to apply significant judgment when evaluating what is a part of the initial formation transaction.

Recognizing and measuring the JV's net assets

At the formation date, a JV would recognize its assets, liabilities and noncontrolling interests using the business combination guidance in Subtopic 805-20. That is, they would be recognized and measured at fair value, with certain exceptions. The business combination guidance would apply regardless of whether the net assets meet the definition of a business.

Goodwill would be measured as the excess of the JV's formation date fair value over the fair value of the JV's assets, liabilities and noncontrolling interest. The JV's formation date fair value would equal the fair value of 100% of the JV's equity immediately following formation. However, if the fair value of the JV's net assets exceeds the JV's equity value, the bargain gain would be recorded as an equity adjustment.

The proposed ASU would not change any guidance about the venturer's accounting. The venturer in a JV also would generally measure its investment at fair value and account for it using equity method accounting. Under current practice, the difference between the amount recorded by the venturer at fair value and the measurement of the JV's net assets often creates basis differences that are tracked and accounted for under the equity method. The Board indicated that having the JV use fair value measurements would reduce amount of the basis differences for the venturers.

Although both the venturer and JV use fair value measurements, the venturer may still have an equity method basis difference. This is because the proposed ASU's requirement to measure the JV's net assets on 100% of its equity interest might include a control premium, while the venturer's investment generally would not.

Clarifications on how business combination guidance applies

The proposed ASU also provides the following clarifications on applying the business combination guidance to a JV formation.

Contingent payment arrangements	Contingent payments between the JV and its owners would be accounted for as a contingent liability or asset under Subtopic 805-20 instead of the contingent consideration guidance in Subtopic 805-30.
Preexisting relationships and acquisition-related costs	The guidance in Subtopic 805-10 on preexisting relationships and acquisition-related costs would not apply. This is because a joint venture would be accounted for as the formation of a new reporting entity.
Replacement share-based payment awards	Equity-classified replacement share-based payment awards would be measured at fair value based on Topic 718. The fair value of these awards would not have an impact on the total amount of equity or goodwill recognized upon formation; instead, it would be recognized as a reallocation of additional paid-in capital.
Private company accounting alternative	A JV that is a private company would be able to apply the accounting alternative for recognizing identifiable intangible assets. Electing this accounting alternative would require also electing the accounting alternative for amortizing goodwill (Subtopic 350-20), which requires amortizing goodwill on a straight-line basis over 10 years, or fewer than 10 years if a shorter useful life is demonstrably more appropriate.

Transfers of financial assets	A JV would apply the guidance in Subtopic 860-10 to determine whether to recognize transferred financial assets. The Board decided this to align the accounting between the venturer that transfers financial assets and the JV that receives financial assets.
Measurement period adjustments	A JV would be prohibited from applying the measurement period guidance in Section 805-10-25 in a formation transaction. The Board decided this because a JV generally would have sufficient information available to recognize and measure its net assets upon formation without the use of a measurement period.
Scope exceptions	The proposed ASU would not apply to entities that are proportionately consolidated by one or more owners and not-for-profit entities.

Disclosures

The proposed ASU would require a JV to disclose information enabling financial statements users to understand the nature and financial effect of the JV formation in the period in which the formation date occurs, including the following:

- the formation date;
- a description of the purpose for which the JV was formed;
- the formation-date fair value of the JV as a whole;
- a description of the assets and liabilities recognized by the JV at the formation date;
- the amounts recognized for each major class of assets and liabilities as a result of accounting for its formation; and
- a qualitative description of the factors that make up the goodwill recognized.

To satisfy the disclosure requirements for amounts recognized for each major class of assets and liabilities, a JV would have the option of presenting a statement of financial position as of the formation date in lieu of note disclosure.

The proposed ASU does not have specific guidance on whether the periods presented in a JV's financial statements should include periods before the formation date or comparative financial statements. However, the JV may need to evaluate whether predecessor financial statements are required by regulators or financial statements users.

Effective dates and transition

The effective date will be determined after the Board considers stakeholders' feedback on the proposed ASU. JVs formed after the effective date would apply the proposed ASU prospectively to their formation transactions; JVs formed before the effective date could elect to apply the ASU retrospectively.

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