FASB issues ASU

Accounting for joint venture formations

August 24, 2023

ASU 2023-05 requires a joint venture formation transaction to be measured at fair value.

Source and applicability

- ASU 2023-05, 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 ASU introduces Subtopic 805-60, containing new accounting requirements for the formation of a JV. These requirements apply to the separate financial statements of an entity that meets the US GAAP definition of a JV (or a corporate JV).

The ASU addresses current diversity in practice by specifying how net assets contributed to a JV are accounted for on the JV's formation. After the ASU, in a JV formation transaction a JV is 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 ASU allows existing JVs to apply the guidance retrospectively. Therefore, if a JV 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. See Effective dates and transition.

What the ASU does not do: It does 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.

Background

Pre-ASU 2023-05, US GAAP did not provide guidance on how a JV should initially recognize and measure net assets contributed upon its formation. In fact, JV formation transactions were explicitly scoped out of Topic 805 (business combinations) − even when two existing business were combined − and Topic 845 (nonmonetary transactions). This lack of guidance led to diversity in practice, with some JVs initially measuring their net assets at carryover basis and others at fair value.

ASU 2023-05 addresses this diversity in practice by creating Subtopic 850-60 to provide guidance on the accounting treatment of JV formations. However, it does 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 does not amend the definition of a JV, which is currently contained in the ASC Master Glossary.

> The scope of Subtopic 850-60 is 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 has objected to a conclusion that joint control is the only defining characteristic of a JV.

A new basis of accounting

Under ASU 2023-05, a JV formation is the creation of a new reporting entity (not necessarily the creation of a new legal entity) that would trigger a new basis of accounting. Therefore, the ASU requires net assets contributed to the JV in a formation transaction to be measured at fair value at the formation date.

Formation date

A JV applies 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.

ASU 2023-05 provides guidance on whether to combine two or more transactions into a single formation transaction. This guidance is consistent with the guidance in Subtopic 810-10 on combining multiple transactions for the sale or derecognition of a business. When multiple transactions are combined, the net assets contributed are measured at their formation date fair value but not recognized until they have satisfied the recognition criteria in Subtopic 805-20. This could lead to a disconnect between the measurement and recognition date if certain assets are contributed after the formation date.

In addition, ASU 2023-05 requires JVs to identify transactions that, while included in the contractual arrangement, are to be accounted for separately from the formation transaction. They do so by applying existing guidance in Topic 805 on identifying transactions separate from a business combination.

> ASU 2023-05 applies only to initial formation transactions. Other US GAAP applies to subsequent contributions, which are 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 recognizes its assets, liabilities and noncontrolling interests using the business combination guidance in Subtopic 805-20. That is, they are recognized and measured at fair value, with certain exceptions. The business combination guidance applies regardless of whether the net assets meet the definition of a business.

Goodwill is 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 equals 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 is recorded as an equity adjustment.

While business combination accounting, and therefore recognition of goodwill, applies to all JV formation transactions regardless of whether the JV meets the definition of a business, the FASB indicated it would be unusual for more than in insignificant amount of goodwill to be present if a JV does not meet the definition of a business.

ASU 2023-05 does 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. Before ASU 2023-05, the difference between the amount recorded by the venturer at fair value and the measurement of the JV's net assets often created basis differences that were tracked and accounted for under the equity method. The Board indicated that having the JV use fair value measurements would reduce the amount of the basis differences for the venturers.

Although both the venturer and the JV use fair value measurements, the venturer may still have an equity method basis difference. This is because ASU 2023-05's requirement to measure the JV's net assets on 100% of its equity interest would factor in any control premium, while the venturer's investment generally would not.

Clarifications on how business combination guidance applies

ASU 2023-05 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 are accounted for as a contingent liability or asset under Subtopic 805-20, which means the contingent consideration guidance in Subtopic 805-30 does not apply.
Preexisting relationships and acquisition-related costs	The guidance in Subtopic 805-10 on preexisting relationships and acquisition-related costs does not apply. This is because a joint venture is accounted for as the formation of a new reporting entity.
Replacement share-based payment awards	Equity-classified replacement share-based payment awards are measured at fair value based on Topic 718. The fair value of these awards does not impact the total amount of equity or goodwill recognized upon formation; instead, it is recognized as a reallocation of additional paid-in capital.
Private company accounting alternative	A JV that is a private company is able to apply the accounting alternative for recognizing identifiable intangible assets. Electing this accounting alternative requires 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 applies the guidance in Subtopic 860-10 to determine whether to recognize transferred financial assets. The Board adopted this requirement to align the accounting between the venturer that transfers financial assets and the JV that receives financial assets.

Measurement period adjustments	The measurement period guidance in Section 805-10-25 applies to a JV formation transaction. Certain disclosures are required during the measurement period.
Scope exceptions	ASU 2023-05 does not apply to entities that are proportionately consolidated by one or more owners, not-for-profit entities and collaborative arrangements.

Disclosures

ASU 2023-05 requires a JV to disclose information enabling financial statement 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 has the option of presenting a statement of financial position as of the formation date in lieu of note disclosure.

ASU 2023-05 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

	All joint ventures
Joint ventures with a formation date on or after	January 1, 2025
Early adoption permitted?	Yes, in any interim or annual period for which financial statements have not yet been issued (or made available for issuance).

The transition method depends on the timing of the formation date.

Formation date	Transition method
On or after the initial application date of ASU 2023-05	Prospective
Before the initial application date of ASU 2023-05	Retrospective, if the joint venture has sufficient information available

Applying the retrospective transition method

If the retrospective transition method is applied, the joint venture:

- recognizes the cumulative effect of initially applying ASU 2023-05 as an adjustment to the opening balance of retained earnings at the initial application date;
- applies any relevant guidance as it existed at the formation date; and
- provides the transition disclosures in paragraphs 250-10-50-1 to 50-3 in the period that includes the initial application date.

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