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Snapshot

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Improved accounting guidance for joint ventures

The FASB issued ASU 2023-05, *Business Combinations – Joint Venture Formations (Subtopic 805-60)*, with the dual objective of (1) providing decision-useful information to the users of a joint venture's financial statements, and (2) reducing diversity in practice with regard to how a joint venture or corporate joint venture (collectively referred to as a JV) accounts for the contributions it receives from its venturers upon formation. The amendments do not affect the definition of a joint venture or corporate joint venture. Entities should perform a careful analysis to determine if the definitions are met.

Although U.S. GAAP previously stipulated that transactions between a JV and its owners are outside the scope of both ASC 845 and ASC 805, it lacked specific accounting guidance on how a JV, upon formation, should recognize and initially measure assets contributed and liabilities assumed, resulting in diversity in practice. Specifically, some JVs initially measured their contributed net assets at fair value at the formation date, while others initially measured their contributed net assets at the venturers' precontribution carrying amounts.

In response, the FASB is requiring JVs, upon formation, to apply a new basis of accounting—similar to fresh start or push down accounting under ASC 805—and to recognize contributed net assets generally at fair value as of the JV's formation date. To accomplish this, the amendments in ASU 2023-05 require a JV to apply the guidance applicable to an acquirer in a business combination in ASC 805, with several important adaptations specifically for JV formations:

- A JV is considered the formation of a new entity without an accounting acquirer.
- A JV should measure its identifiable net assets and goodwill, if any, at the formation date.
- Initial measurement of a JV's total net assets, including goodwill and noncontrolling interest (NCI), equals the fair value of 100 percent of its equity on the formation date.
- A JV formation transaction should have unique disclosures.

Additionally, many of the exceptions in ASC 805 that do not require the acquirer in a business combination to measure acquired assets and assumed liabilities at fair value now apply to the JV in its financial statements at the formation date.

The amendments outline the following steps for a JV to follow when accounting for its contributed net assets at formation:

a. Determining the formation date
b. Recognizing and measuring the identifiable assets, the liabilities, and any NCI in the net assets recognized by the JV

c. Recognizing and measuring goodwill, if any, using the fair value of the JV as a whole immediately following formation

Determining the formation date

According to the amendments in ASU 2023-05, the JV formation date is the date when an entity initially meets the definition of a JV, which is not necessarily the same date as the JV legal entity formation date. The formation date is also the measurement date for the JV formation transaction. If the transaction or event is not a JV formation, the reporting entity should account for the transaction or event in accordance with other U.S. GAAP.

Multiple arrangements

A JV may be formed as the result of multiple arrangements that constitute a single JV formation transaction. In other words, multiple arrangements may in substance be treated as a single JV formation transaction. If multiple arrangements are accounted for as a single transaction that establishes the formation of a joint venture, the formation date is still the date when the entity meets the definition of a JV.

If multiple arrangements are accounted for as a single transaction that establishes the formation of a JV, the formation date is the measurement date for all arrangements that form part of the single JV transaction. That is, the assets and liabilities contributed to the JV through the various arrangements that constitute a single formation transaction are measured at fair value on the formation date in the JV's standalone financial statements, regardless of when the JV received the assets or assumed the liabilities. In other words, there could be a timing difference between measurement and recognition.

In determining whether to account for the multiple arrangements as a single transaction, a JV should consider the terms and conditions of the arrangements and their economic effects. The amendments provide the following indicators to assist in this assessment, any one of which on its own may suggest that a multiple arrangement should be accounted for as a single JV formation transaction:

- Arrangements are entered into at the same time or in contemplation of one another.
- Arrangements form a single transaction designed to achieve an overall commercial effect.
- The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
- One arrangement considered on its own is not economically justified, but the multiple arrangements are economically justified when considered together.

Recognizing and measuring assets, liabilities, and equity

Once the formation date has been established, a JV must determine which identifiable assets and liabilities are part of the JV formation. These identified assets and liabilities are subject to the recognition and measurement principals outlined below.

The JV must also ascertain which assets and liabilities are not part of the JV formation and are therefore considered a separate accounting transaction accounted for under other relevant GAAP.

Because the formation of a JV also creates a completely new reporting entity from an accounting perspective, there is effectively no pre-existing relationship between the JV and the entities that provided contributions. Accordingly, the JV should not analogize to the guidance for pre-existing relationships in ASC 805 for transactions that are determined not to be part of the JV's formation transaction.

At the formation date, a JV should account for and measure its formation by establishing a new basis of accounting for its identifiable assets and liabilities, as well as for any noncontrolling interest, in accordance with ASC 805-20. The impact of adopting a new basis of accounting is that the JV (1) may recognize assets or liabilities that were previously not recognized by the contributing investors, such as internally developed intangible assets, and (2) should recognize its assets, liabilities, and noncontrolling interests at their fair values on the formation date. However, JVs should also take care to apply the exceptions in ASC 805-20 to the general requirement to recognize acquired assets and assumed liabilities at fair value. A JV should account for its formation in this manner regardless of whether the assets or group of assets recognized by the JV constitutes a "business," pursuant to the definition in ASC 805.

Share-based payments expense attribution

Investors may contribute one or more businesses to the JV that have employees with share-based payment awards. In these situations, the JV must determine which portion of the compensation expense associated with those awards should be attributed to the employees' pre-formation service and to their post-formation service.

If share-based awards in this scenario are replaced with new awards in the JV's equity, the JV should apply the guidance in ASC 805-30-30-9 through 30-13 to determine which portion of the compensation expense associated with the replacement awards should be attributed to the employees' pre-formation service and post-formation service.

Private Company accounting alternative

A JV that is a private company may elect to apply the accounting alternative for recognizing identifiable intangible assets described in ASC 805-20-25-30 through 25-33. Under this accounting alternative, JVs are not required to separately recognize from goodwill certain intangibles, such as certain customer-related intangible assets and noncompetition agreements. However, a JV that elects to apply this accounting alternative must also adopt the accounting alternative for amortizing goodwill.

Instruments, contracts, and share-based payment awards classified as equity

Equity-classified instruments, contracts, and share-based payment awards classified as equity should be accounted for as a reallocation of additional paid-in capital (or other similar equity account, such as members' equity) and do not affect the total amount of equity or goodwill recognized by the JV upon formation.

Liability-classified share-based payment awards

Some share-based payments are classified as liabilities and are not equity-classified. For contributed businesses that have employees with share-based payment awards that are replaced with liability-classified awards in the JV, the JV should initially measure the liability-classified replacement awards under ASC 718.

Asset- or liability-classified contingent payments

A JV formation may involve a contingent consideration arrangement. For instance, upon formation, a JV might promise to make payments or issue additional equity interests to a contributing entity contingent upon the performance of assets or businesses contributed to the JV. A JV should initially measure any contingent payment arrangements between the JV and its venturers that are classified as liabilities (or assets) based on the measurement principles in ASC 805-20. Accordingly, a JV would account for the contingent payment arrangement as a typical contingent asset or liability, rather than applying the specific contingent consideration arrangement guidance under ASC 805-30. Any asset or liability recognized will impact the measurement of goodwill, as described below, as part of the JV formation.

The FASB acknowledged that applying the exceptions to the fair value principle for assets and liabilities arising from contingencies in ASC 805-20 to contingent payments made between the JV and its venturers at JV formation may result in some arrangements that are similar to contingent consideration that are not (a) initially measured at fair value, or (b) subsequently measured at fair value with gains or losses recognized in earnings.

Recognizing and measuring goodwill

Unlike for a business combination, a JV may recognize goodwill even if it does not meet the definition of a business under ASC 805. However, it would be unusual for a JV to record a significant amount of goodwill if, at formation, it does not meet the definition of a business. The goodwill recognized by a JV upon formation is measured as the excess of (a) over (b):

a. The formation-date fair value of the JV as a whole, which equals the fair value of 100 percent of the JV's equity (net assets) immediately following formation, including any NCI in the net assets recognized by the JV.

b. The net amount of the formation-date identifiable assets and liabilities recognized by the JV and measured in accordance with ASC 805-20. Assets and liabilities that are not part of the formation-date amounts are excluded from the goodwill calculation.

Incomplete accounting

If the initial accounting for a JV formation is incomplete by the end of the reporting period in which the formation date occurs, the JV may apply the measurement-period guidance in ASC 805-10-25-13 through 25-19 for those incomplete items, similar to a business combination. The JV should adjust the provisional amounts recognized to reflect new information obtained about facts and circumstances that existed as of the formation date, which, if known, would have affected the measurement of the amounts recognized as of that date. The JV should document and assess on an item-by-item basis the information it has not yet obtained but plans to obtain for an open item. The measurement period for each item closes once the JV has obtained the information necessary and determines no other additional information existed as of the formation date. In any event, the measurement period should not exceed one year from the formation date.

Subsequent measurement and disclosures

A JV should subsequently measure and account for the assets and liabilities recognized upon formation in accordance with the requirements for acquirers of a business in ASC 805-10-35, 805-20-35, and 805-30-35. Although ASC 805 specifies the subsequent accounting for certain items, in general, the subsequent measurement and accounting for assets, liabilities, and equity instruments complies with other applicable GAAP.

The amendments add disclosure requirements that enable financial statement users to understand the nature and financial effect of the JV formation in the period when the formation occurs. Disclosure items include:

- Formation date
- Description of the purpose for which the JV was formed
- Formation-date fair value of the JV as a whole
- Description and amounts recognized of the assets and liabilities at the formation date
- Qualitative description of the factors that make up any goodwill

The amendments also address disclosures for accounting that is initially incomplete for particular assets, liabilities, and noncontrolling interests. Broadly, the disclosures focus on how and why the accounting is incomplete for specific assets, liabilities, and noncontrolling interests. The nature and amount of any measurement-period adjustments should also be disclosed.

Effective date and transition

The amendments are effective prospectively for all JVs formed on or after January 1, 2025.

A JV that was formed before January 1, 2025 may elect to apply the amendments retrospectively if it has sufficient information. Early adoption, either prospectively or retrospectively, is permitted in any interim or annual period in which the financial statements have not yet been issued or been made available for issuance.

The amendments generally do not apply to any of the following:

- Transactions between a JV and its owners other than the formation of the JV
- Formations of entities determined to be not-for-profit entities
- Combinations between entities, businesses, or nonprofit activities under common control
- Entities in the construction or extractive industries that may be proportionately consolidated by any one of their investor-venturers
- Collaborative arrangements

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