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FASB Issues Final Standard on Joint Venture Formations

Overview

On August 23, 2023, the FASB issued ASU 2023-05,[1] under which an entity that qualifies as either a joint venture or a corporate joint venture as defined in the *FASB Accounting Standards Codification* (ASC) master glossary is required to apply a new basis of accounting upon the formation of the joint venture. Specifically, the ASU provides that a joint venture or a corporate joint venture (collectively, "joint ventures") must initially measure its assets and liabilities at fair value on the formation date.

Background

Before the issuance of ASU 2023-05, there was no specific guidance in U.S. GAAP on the accounting for the initial measurement of assets and liabilities contributed to a joint venture at formation. As a result, some joint ventures historically measured such contributions by using the venturers' respective carrying amounts while others recognized the contributions at fair value. The new guidance addresses this diversity in practice by establishing requirements for the recognition and initial measurement of a joint venture's net assets and liabilities on the formation date. The FASB expects that this guidance will increase the consistency in accounting for newly formed joint ventures as well as enhance the usefulness of a joint venture's financial reporting to investors.

[1] FASB Accounting Standards Update (ASU) No. 2023-05, *Business Combinations — Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*.

Main Provisions

The amendments in ASU 2023-05 apply to the formation of a joint venture regardless of whether the joint venture meets the definition of a business in ASC 805-10.[2] Under the ASU:

- The formation of a joint venture results in the "creation of a new reporting entity," and no accounting acquirer is identified under ASC 805. Accordingly, a new basis of accounting is established on the formation date. Paragraph BC23 of the ASU notes that this treatment is "generally consistent with other new basis of accounting models in GAAP, such as fresh-start reporting" under ASC 852.
- A joint venture measures the net assets and liabilities on the formation date, which the ASU defines as "the date on which an entity initially meets the definition of a joint venture." Thus, the formation date is not necessarily the date on which the legal entity was formed (e.g., the assets of the joint venture may be contributed by one or both of the parties to the joint venture at a later point in time).
- A joint venture may establish a measurement period in a manner consistent with the measurement-period guidance in ASC 805-10 for business combinations when it identifies and measures the net assets received.
- The excess of the fair value of a joint venture as a whole over the net assets of the joint venture would be recognized as goodwill. On the formation date, the joint venture's measurement of its net assets would be "equal to the fair value of 100 percent of [its] equity." Although the ASU does not preclude a joint venture from recognizing goodwill if it does not meet the definition of a business, paragraph BC48 of the ASU notes, in a manner consistent with the guidance in ASC 805-10-55-9, that "the Board does not expect that an entity that meets the definition of a joint venture will have more than an insignificant amount of goodwill if it does not already meet the definition of a business."
- In situations in which the net assets of a joint venture exceed the fair value of the joint venture as a whole, the joint venture is required to recognize any "negative goodwill" as an adjustment to equity.
- The treatment of in-process research and development (IPR&D) contributed to a joint venture at formation is aligned with the treatment of IPR&D acquired in a business combination. Therefore, the joint venture would account for IPR&D as capitalized indefinite-lived intangible assets regardless of whether the R&D asset has an alternative future use.

A joint venture is required to provide specific disclosures aimed at giving financial statement users a better understanding of the nature and financial effect of the joint venture's formation in the period in which the formation occurred. Those disclosures include (1) a description of the joint venture's purpose, (2) the fair value of the joint venture on the formation date, (3) the "amounts recognized by the joint venture for each major class of assets and liabilities," and (4) a "qualitative description of the factors that make up any goodwill recognized."

Connecting the Dots

ASU 2023-05 does not change the definition of a joint venture in the ASC master glossary, which is as follows:

> An entity owned and operated by a small group of businesses (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a joint venture frequently is to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in

[2] For titles of ASC references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

> the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a joint venture. The ownership of a joint venture seldom changes, and its equity interests usually are not traded publicly. A minority public ownership, however, does not preclude an entity from being a joint venture. As distinguished from a corporate joint venture, a joint venture is not limited to corporate entities.

Likewise, the ASU does not change the following definition of a corporate joint venture in the ASC master glossary:

> A corporation owned and operated by a small group of entities (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a corporate joint venture frequently is to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A corporate joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. The ownership of a corporate joint venture seldom changes, and its stock is usually not traded publicly. A noncontrolling interest held by public ownership, however, does not preclude a corporation from being a corporate joint venture.

Since the ASU does not change the above definitions, judgment will still be required to determine whether a legal entity meets either of those definitions.

The new guidance does not apply to the following:

a. Transactions between a joint venture and its owners other than the formation of the joint venture

b. Formations of entities determined to be not-for-profit entities in accordance with Topic 958

c. Combinations between entities, businesses, or nonprofit activities under common control . . .

d. Entities in the construction or extractive industries that may be proportionately consolidated by any of their investor-venturers in accordance with paragraph 810-10-45-14

e. Collaborative arrangements within the scope of Topic 808, except for any part of the arrangement that is conducted in a separate legal entity that meets the definition of a joint venture.

Effective Date and Transition

Effective Date

The amendments in ASU 2023-05 are effective for all joint ventures within the ASU's scope that are formed on or after January 1, 2025. Early adoption is permitted.

Transition

Joint ventures formed on or after the effective date of ASU 2023-05 will be required to apply the new guidance prospectively. Joint ventures formed before the ASU's effective date are permitted to apply the new guidance (1) retrospectively if they have "sufficient information" to do so or (2) prospectively if financial statements have not yet been issued (or made available for issuance). If retrospective application is elected, transition disclosures must be provided in accordance with ASC 250.

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