Heads Up | Volume 30, Issue 9
May 11, 2023

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FASB Authorizes Staff to Draft Final Standard on Joint Venture Formations

Overview

At its April 5, 2023, meeting, the FASB discussed feedback from constituents on its proposed ASU[1] on joint venture formations, which would establish a new basis of accounting for most entities that meet the definition in ASC 323[2] of a joint venture. The Board authorized the FASB staff to draft a final ASU that would (1) require a joint venture to initially measure its assets and liabilities at fair value upon the formation date[3] and (2) permit the joint venture to apply measurement-period guidance in accordance with ASC 805.

Background

Currently there is 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 measure such contributions by using the respective carrying amounts of the venturer while others recognize them at fair value. The new guidance would address 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 anticipates that this guidance would 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 Proposed Accounting Standards Update (ASU), *Business Combinations — Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*.

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

[3] Under ASC 805-60-25-3 of the proposed ASU, the formation date would be "the date on which an entity initially meets the definition of a joint venture." Thus, the formation date may not necessarily be the formation date of the legal entity.

Main Provisions

The Board reaffirmed the following provisions from the proposed ASU:

- The formation of a joint venture would result in the "creation of a new reporting entity," and no accounting acquirer would be identified under ASC 805. Accordingly, a new basis of accounting would be established upon the formation date.
- The joint venture would measure the net assets and liabilities on the formation date (i.e., when it initially meets the definition of a joint venture). The excess of the fair value of the joint venture as a whole over the net assets and liabilities of the joint venture would be recognized as goodwill.
- Upon the formation date, a joint venture's measurement of its net assets and liabilities would be "equal to the fair value of 100 percent of [its] outstanding equity interests."

In response to feedback, the FASB revisited the proposed ASU's measurement guidance and decided that a joint venture may establish a measurement period when identifying and measuring the net assets and liabilities received by the joint venture. The Board's decision is consistent with the measurement-period guidance in ASC 805 related to business combinations.

A joint venture would also be required to disclose the formation date, a qualitative description of the joint venture's purpose, the fair value of the joint venture on the formation date, the "amounts recognized by the joint venture for each major class of assets and liabilities," and a "description of the factors that make up any goodwill recognized."

In addition, the FASB notes in the proposed ASU that its guidance on requiring the application of a new basis of accounting is "consistent with other new basis of accounting models in GAAP," such as fresh-start reporting under ASC 852.

Connecting the Dots

The new guidance would not change the definition of a joint venture under ASC 323 and 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 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.

The new guidance would not apply to collaborative arrangements under ASC 808, not-for-profit entities, or entities within the "construction or extractive industries that may be proportionately consolidated by their investor-venturers."

Effective Dates and Transition

Effective Dates

The new guidance would be effective for all joint ventures within the standard's scope that are formed on or after January 1, 2025. Early adoption would be permitted.

Transition

At the April 5 meeting, the FASB affirmed its decision that new joint ventures formed as of or after the effective date would be required to apply the guidance prospectively. Joint ventures formed before the effective date would be permitted to apply the proposed guidance retrospectively if they have "sufficient information available to do so."

Next Steps

The final ASU is expected to be issued at the end of the third quarter of 2023. The FASB staff will continue to assess and present to the Board any additional issues identified during the drafting period.

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