FORsights

New JV Accounting Rules – Fair Value

On August 23, 2023, FASB issued Accounting Standards Update (ASU) 2023-05, providing—for the first time—recognition and initial measurement for joint ventures (JVs). To reduce diversity in practice and provide decision-useful information to investors, a JV would be required to apply a new basis of accounting. At formation, a newly formed JV would initially generally measure its assets and liabilities at fair value. The ASU does not change the JV definition, the accounting by an equity method investor for its JV investment, or the accounting by a JV for contributions received after formation.

Early adoption is permitted and existing JVs have an option to apply the guidance retrospectively.

Effective Dates ASU 2023-05	All Entities For JV formations on or after January 1, 2025

Background

Current accounting rules do not provide specific authoritative guidance on how a JV, at formation, should recognize and initially measure assets contributed and liabilities assumed. Current guidance in Accounting Principles Board (APB) Opinion No. 29, *Accounting for Nonmonetary Transactions*, issued in 1973, explicitly provides that transactions between a corporate JV and its owners are outside the scope of Accounting Standards Codification (ASC) 845, *Nonmonetary Transactions*. Statement 141 excludes JV formation from the scope of ASC 805, *Business Combinations*. In the absence of specific guidance, practice has been influenced by various sources, including speeches given by the SEC staff that, not surprisingly, have given rise to diversity in practice. Some JVs initially measure their net assets at fair value at the formation date, while other JVs account for their net assets at the venturers' carrying amounts.

Scope

The ASU covers the accounting for contributions received (both monetary and nonmonetary) upon formation by entities that meet the JV or a corporate JV definition, collectively called JVs in this article.

Scope Exclusions

The changes would not apply to:

- Transactions between a JV and its owners other than the formation of a JV
- Formations of entities determined to be not-for-profit entities under ASC 958, *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 their investor-venturers
- Collaborative arrangements within the scope of ASC 808, *Collaborative Arrangements*.

New Guidance

The formation of a JV is the creation of a new reporting entity, and none of the assets and/or businesses contributed to the JV are viewed as having survived the combination as an independent entity; therefore, no accounting acquirer will be identified.

Formation Date

Determining the formation date is a critical first step because the JV will measure its identifiable net assets and goodwill, if any, at the formation date. The JV formation date is the date on which an entity initially meets the JV definition,[1] which may not be the legal formation date.

Multiple Arrangements

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 formation transaction. The ASU provides a list of indicators to account for multiple arrangements as a single transaction:

- The multiple arrangements are entered into at the same time or in contemplation of one another.
- The multiple 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.

> Because a JV is accounted for as the formation of a new reporting entity whose history begins on that formation date, the ASU prohibits a JV from applying the guidance in ASC 805-10 for settling a pre-existing relationship and accounting for acquisition-related costs.

Measurement

Initial measurement of a JV's total net assets is equal to the fair value of 100% of the JV's equity immediately following formation (including any noncontrolling interest in the net assets recognized by the JV).

---

[1] 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 group members. A government also may be a member of the group. The purpose of a JV 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 JV also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the JV. 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 JV. The ownership of a JV seldom changes, and its equity interests usually are not traded publicly. A minority public ownership, however, does not preclude an entity from being a JV. As distinguished from a corporate JV, a JV is not limited to corporate entities.

Contingent Payments

It is common for JVs to have arrangements similar to a contingent consideration arrangement found in a business combination. For example, upon formation, a JV might promise to make payments or issue additional equity interests to a venturer contingent based on the performance of contributed assets. Because the JV's total net assets (including goodwill) are measured on the basis of the JV as a whole upon formation instead of consideration transferred, it may be challenging to identify contingent consideration arrangements as defined in ASC 805-30*, Business Combinations—Goodwill or Gain from Bargain Purchase, Including Consideration Transferred*.

For **liability-classified (or asset-classified) instruments**, the ASU requires that any contingent arrangements that are part of the JV formation and classified as liabilities follow the guidance in ASC 805-20, *Identifiable Assets and Liabilities, and Any Noncontrolling Interest*. FASB acknowledged that this accounting may result in a different outcome than using guidance in ASC 805-30, which requires initial and subsequent measurement at fair value. Using ASC 805-20 may result in some arrangements that are similar to contingent consideration that are (a) not initially measured at fair value or (b) not subsequently measured at fair value with gains or losses recognized in earnings.

For any **equity-classified** instruments and contracts recognized separately upon formation, the ASU clarifies that amounts recognized by a JV upon formation will not increase total net assets, goodwill, or equity but, instead, will be accounted for as a reallocation of additional paid-in capital (or other similar equity account, such as members' equity).

Share-Based Payment Awards

A JV may issue replacement share-based payment awards to the grantees of the contributed entities as part of a JV formation. A JV would initially measure liability- or equity-classified replacement share-based payment awards using the fair-value-based measurement method under ASC 718, *Stock Compensation*, which is consistent with business combination guidance.

Private Company Alternatives

A JV that is a private company may elect to apply the accounting alternative for the recognition of identifiable intangible assets.[2] A JV electing this alternative also must adopt the private company accounting alternative for amortizing goodwill.

In-Process Research & Development (IPR&D)

To align the requirements for IPR&D contributed to a JV upon formation and acquired through a business combination, the ASU requires that a JV capitalize any contributed tangible and intangible research and development assets, regardless of whether those assets have an alternative future use.

[2] Under this accounting alternative, an acquirer shall not recognize separately from goodwill the following intangible assets: customer-related intangible assets unless they are capable of being sold or licensed independently from other assets of a business noncompetition agreements. Examples include mortgage servicing rights, commodity supply contracts, core deposits, and customer information. ASC 606 contract assets, and favorable and nonfavorable leases, are not in scope for this alternative.

After formation, a JV must account for IPR&D intangible assets as indefinite-lived until the completion or abandonment of the associated research and development efforts, and account for tangible assets that are used in research and development activities in accordance with their nature.

Goodwill

The ASU also aligns the treatment of goodwill for a JV formation with the business combination guidance. A JV will be required to recognize as goodwill the fair value of the JV as a whole in excess of identifiable net assets upon formation, if any. This requirement applies regardless of whether a JV, or the net assets contributed to a JV upon formation, meets the definition of a business in ASC 805. The ASU requires that any negative goodwill at formation be recognized as an adjustment to additional paid-in capital or other similar equity account.

FASB expects that it will be unusual that an entity simultaneously (a) meets the JV definition, (b) has net assets with a fair value that more than insignificantly exceeds that of its identifiable net assets, and (c) is not a business.

Transfers of Financial Assets

Topic 860, *Transfers and Servicing*, addresses whether a transfer of financial assets represents a sale or a secured borrowing depending on control considerations. If financial assets within the scope of ASC 860 are transferred to the JV at formation, guidance in ASC 860 should be used to determine if the transfer results in the recognition of the transferred financial assets. This will align the accounting for such assets between the contributor and the JV.

Measurement Guidance for Incomplete Initial Accounting

If the initial accounting is incomplete at the end of a reporting period, entities should follow existing guidance in ASC 805 for the items that are incomplete:

"During the measurement period, the acquirer shall recognize adjustments to the provisional amounts with a corresponding adjustment to goodwill in the reporting period in which the adjustments to the provisional amounts are determined. Thus, the acquirer shall adjust its financial statements as needed, including recognizing in its current-period earnings the full effect of changes in depreciation, amortization, or other income effects, by line item, if any, as a result of the change to the provisional amounts calculated as if the accounting had been completed at the acquisition date."

If this measurement period guidance is used, disclosure is required.

Disclosures

A JV's required disclosures should help a financial statement user understand the nature and financial effect of the JV formation in the period in which the formation date occurs. JV disclosure requirements upon formation are more streamlined than for a business combination and should include the following:

- The formation date
- A description of the purpose for which the JV was formed, *e.g.*, to share risks and rewards in developing a new market, product, or technology; combine complementary technological knowledge; or to pool resources in developing production or other facilities

- 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 by the JV for each major class of assets and liabilities as a result of accounting for its formation, either presented on the face of financial statements or disclosed in the financial statement notes
- A qualitative description of the factors that make up any goodwill recognized, such as expected synergies from combining operations of the contributed assets or businesses, intangible assets that do not qualify for separate recognition, or other factors

If the JV's initial accounting is incomplete for particular assets, liabilities, noncontrolling interests, or the formation-date fair value of the JV as a whole and the amounts recognized in the financial statements for the JV formation have been provisionally determined, the following disclosures are required:

- The reasons why the initial accounting is incomplete
- The assets, liabilities, noncontrolling interests, or the formation-date fair value of the JV as a whole for which the initial accounting is/are incomplete
- The nature and amount of any measurement period adjustments recognized during the reporting period, including separately the amount of adjustment to current-period income statement line items relating to the income effects that would have been recognized in previous periods if the adjustment to provisional amounts was recognized as of the formation date

Effective Date & Transition

ASU 2023-05 will be effective for all JV formations with a formation date on or after January 1, 2025 on a prospective basis. Early adoption is permitted in any interim or annual period if financial statements have not yet been issued (or made available for issuance), either prospectively or retrospectively.

Retrospective Adoption

A JV formed before the effective date can elect to apply the ASU retrospectively if sufficient information is available. If elected, the cumulative effect of initially applying the ASU would be an adjustment to the opening balance of retained earnings at the initial application date. The initial application date would be the beginning of the earliest comparative period presented.

If the ASU is adopted on a retrospective basis, the standard change in accounting principle disclosures in ASC 250 would apply in the period of adoption.

Conclusion

The assurance team at Forvis Mazars delivers extensive experience and skilled professionals to assist with your objectives. Our proactive approach includes candid and open communication to help address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. Whether you are publicly traded or privately held, Forvis Mazars can help provide an independent and objective view of your financial reporting. We leverage the latest technologies and process automation tools to provide companies assurance on their financial statements to help meet stakeholders' needs.

Contributor

Anne Coughlan
Director
anne.coughlan@us.forvismazars.com