JOINT VENTURE FORMATIONS

December 2023

OVERVIEW

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2023-05, *Business Combinations – Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*, in August 2023. The ASU was issued to address the current diversity in practice when accounting for joint venture formations in the separate financial statements of the joint venture. Currently, transactions between a corporate joint venture and its owners are outside the scope of Accounting Standards Codification (ASC) 845, *Nonmonetary Transactions*, and the accounting for the formation of a joint venture is outside the scope of ASC 805, *Business Combinations*. Although there is a definition for "joint venture" in FASB's ASC Master Glossary, the lack of guidance on the initial measurement of assets contributed and liabilities assumed in a newly formed joint venture has led to diversity in practice.

To reduce the diversity in practice and improve the usefulness of information provided to a joint venture's investors, ASU 2023-05 requires a newly formed joint venture to apply a new basis of accounting for its identifiable assets and liabilities and any noncontrolling interest. Therefore, in accordance with the new guidance, a joint venture will initially measure its assets and liabilities at fair value at the date of formation with certain exceptions that are consistent with those in ASC 805.

This white paper covers the requirements of ASU 2023-05, including the scope, steps required to apply the guidance, disclosures, and the transition method and effective date. Additionally, the white paper briefly highlights how to apply the existing joint venture definition and the accounting at formation by the venturers.

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1. Overview

Accounting Standards Update (ASU) 2023-05, *Business Combinations – Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement* was issued in August 2023 to address the current diversity in practice when accounting for joint venture formations in the separate financial statements of the joint venture (JV). To reduce the diversity in practice and improve the usefulness of information provided to a JV's investors, ASU 2023-05 establishes a new ASC Subtopic, 805-60, which requires a newly formed JV to apply a new basis of accounting for its identifiable assets and liabilities and any noncontrolling interest at formation.

Under the new requirements in ASC 805-60, the following steps should be applied in accounting for a JV at formation:

- Determine the formation date.
- Recognize and measure any identifiable assets, liabilities, and any noncontrolling interest in accordance with ASC 805-20, *Business Combinations — Identifiable Assets and Liabilities, and Any Noncontrolling Interest.*
- Recognize and measure goodwill, if any, utilizing the fair value of the JV as a whole immediately after formation.

ASU 2023-05 also requires a JV to disclose information about the nature and financial effects of the JV formation in the period in which the formation date occurs. The new standard is effective for JVs with formation dates on or after January 1, 2025. Early adoption is permitted in any interim or annual period. The required application method for the standard is prospective. Full retrospective application is available for any JVs formed before January 1, 2025, that voluntarily decide to adopt the guidance, subject to the availability of sufficient information to do so.

The following sections provide further detail about the scope of ASC 805-60; steps to undertake when accounting for the financial statements of a JV at formation; and the required disclosures, transition method and effective date. Apart from ASC 805-60, this white paper also includes sections on applying the existing JV definition and the accounting by venturers at formation. Throughout this white paper, we refer to relevant sections of RSM's *A Guide to Accounting for Business Combinations* (GABC) for further details on how to apply ASC 805-20. These references will be displayed as GABC Chapter X or GABC Section X.X.

2. Scope

2.1 General scope requirements for JV formations

The scope of ASC 805-60 applies only to the financial statements of a JV at formation. ASU 2023-05 does not amend the existing ASC Master Glossary definition of JV (or corporate JV). Generally, all JVs with a formation date after the effective date are required to follow this new guidance; however, there are specific JV entities that are exempted from the required guidance in ASC 805-60. In accordance with ASC 805-60-15-4, the following are excluded from the scope of the new guidance:

- Transactions between a JV and its owners other than the JV formation
- Combinations between entities, businesses, or nonprofit activities under common control
- Formations of entities determined to be not-for-profit entities in accordance with ASC 958, *Not-for-Profit Entities*
- Entities in the construction or extractive industries that may be proportionately consolidated by any of their investor-venturers in accordance with ASC 810-10-45-14

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- Collaborative arrangements within the scope of ASC 808, *Collaborative Arrangements,* except for any part of the arrangement that is conducted in a separate legal entity that meets the definition of a JV.

Additionally, the scope of ASU 2023-05 does not amend the accounting by an equity method investor for its investment in a JV. Investors in JV entities will continue to follow the guidance in ASC 323-10, *Investments—Equity Method and Joint Ventures — Overall*.

2.2 Applying the existing definition of JV

2.2.1 Overview

The definitions of JV and corporate JV in the ASC Master Glossary were not amended by ASU 2023-05. Other than the definitions, there is little prescriptive guidance in U.S. generally accepted accounting principles (GAAP) on identifying JVs. Therefore, the term "JV" is often used in practice for legal entity structures or transactions that do not meet the accounting definition of JV and also may be used loosely in legal or organizational documents or in communications by management. Determining whether a legal entity meets the accounting definition of a JV can be a complex exercise, but it is vital to applying the appropriate accounting by both the investors (venturers) and the investee (JV itself).

A JV is defined as follows.

Definition from ASC Master Glossary

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 definition includes several characteristics of an entity that should be present in order for that entity to be a JV. Despite this, there may be perception in practice that joint control is the only required characteristic for a legal entity to meet the accounting definition. This is because joint control is a JV's primary distinguishing characteristic from other similar entities or arrangements and has been described in historical, non-authoritative guidance. However, the SEC staff has objected to this notion in the past as described in ASC 805-10-S99-8. At the 2014 AICPA National Conference on Current SEC and PCAOB Developments, Christopher Rogers, a professional accounting fellow in the SEC's Office of the Chief Accountant stated, in part, the following related to the required characteristics of a JV entity:

> In evaluating joint venture formation transactions, the staff continues to believe that joint control is not the only defining characteristic of a joint venture. Rather, each of the characteristics in the definition of a joint venture in Topic 323 should be met for an entity to be a joint venture, including that the "purpose" of the entity is consistent with that of a joint venture.
>
> Importantly, the definition of a joint venture in Topic 323 provides that "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.

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Building off the definition and subsequent SEC remarks, we believe that in order for an entity (regardless of whether it is public and private) to meet the definition of a JV, it must have all the following characteristics:

- It is organized as a separate legal entity.
- It is jointly controlled by the venturers.
- It is operated for the mutual benefit of the venturers.
- It has a purpose to share the 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.

Despite the requirement to meet each of the characteristics of the JV definition, the analysis of whether a legal entity meets the definition should start with determining whether the entity should be consolidated by any of the individual investors. That analysis should be performed in accordance with ASC 810-10, *Consolidation — Overall,* and is outside the scope of this white paper. If it is determined under ASC 810-10 that an entity should be consolidated by one of its investors, then the entity will not meet the definition of a JV and is excluded from the scope of ASC 805-60.

2.2.2 Organized as a separate legal entity

The organization of a separate legal entity by the venturers is a foundational component of the JV definition. Without a separate legal entity, it would be difficult to determine whether the arrangement is operating independently from one or more of the venturers and capable of being jointly controlled by the venturers through their investments. Therefore, a separate legal entity must be organized so that the operations of the JV have the ability to be jointly controlled by the venturers and each of the venturers can participate in the entity's significant decision-making.

A JV is not required to be organized in any specific legal form. That is, a JV entity could be a corporation, partnership, limited-liability company or other unincorporated entity that meets the ASC Master Glossary definition of legal entity. The structure of the separate legal entity could have implications for the accounting at formation (e.g., whether the legal entity is taxable or not).

The rationale for the recognition and measurement of JVs at formation in ASC 805-60 supports this aspect of the definition. That is, the contributions from the venturers result in a change in control event in that it is the JV that now controls those assets and liabilities rather than any one venturer.

If an arrangement appears to meet the majority of the characteristics of a JV, but a separate legal entity has not been established, it could be a collaborative arrangement as defined by ASC 808. As noted in Section 2.1, collaborative arrangements are excluded from the scope of ASC 805-60.

2.2.3 Jointly controlled by the venturers

Joint control is the characteristic that differentiates JVs from other entities. While not explicitly stated in the ASC definition, the concept of joint control is evident through the various characteristics described such as the venturers "participating, directly or indirectly, in the overall management of the joint venture" and having "an interest or relationship other than passive investors". Additionally, the concept of joint control would preclude an entity from being a subsidiary of a venturer (that is, consolidated by that venturer).

Joint control is applied in practice as existing when all the significant decisions for an entity, such as those related to financing, development, or investing, require unanimous consent by all the investors (venturers). Under this application, each of the venturers must have substantive approval or veto rights related to all significant decisions, such that each venturer could prevent other venturers from making those decisions. This is different than the notion of participating in all significant decisions of the entity

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where a majority ruling becomes effective. Therefore, in evaluating whether joint control exists, it becomes particularly important to understand the governance structure and rights of each investor.

Example 2-1: Application of joint control

Entity D is a separate legal entity formed by Investor A, Investor B and Investor C. Primarily all decisions that significantly affect the operations of Entity D are made by the board of directors. One director is appointed by each of the investors and the decisions that are made by the board require unanimous consent by each of them. Entity D also has a separate Investing Committee that each of the investors appoints one member to. The decisions of the Investing Committee are made by a majority vote of the three members.

Under these circumstances, Entity D would not meet the definition of a JV due to the joint control characteristic, as not all significant decisions of the entity require the consent of all the investors. Investing decisions would generally be considered significant, and in this example those decisions can be made with the vote of only two of the three investors.

Due to the requirement under the joint control characteristic that unanimous consent is necessary for all significant decisions, there are likely to be situations in which a unanimous decision cannot be reached. In those situations, it is important to understand the rights of each investor in attempting to settle those disagreements. These will usually be outlined in the contractual arrangement for the separate legal entity. For example, the disagreement between the investors may go to arbitration to be resolved. The process of going through arbitration to settle these disagreements does not preclude the investors from meeting the joint control characteristic. However, if one investor has the ability or authority to break the deadlock on significant decisions, joint control would not exist.

2Q.2.3.1 In situations in which only one investor has control over decisions that are not significant to the entity's operations, would the entity be able to meet the joint control characteristic?

Situations in which one or more, but not all, investors have control over decisions that are not significant to the JV's operations would not preclude the joint control characteristic from being met. For example, a contract with one of the venturers to supply an operations manager to perform day-to-day management of the entity in line with the significant operating decisions made by the investors would not on its own be a determining factor in whether the joint control characteristic is met. However, this type of arrangement should be scrutinized to comprehensively evaluate whether the operations manager has control over significant decisions. This evaluation should be performed in accordance with the guidance in ASC 810-10.

2Q.2.3.2 Can joint control exist with more than two or three venturers?

The ASC definition of JV requires that a JV be owned by a small group of entities (venturers), yet there is no prescriptive guidance on whether there is a limit to the number of venturers in a JV. In general, we believe that the larger the number of venturers in a JV, the more difficult it would be to reach unanimous consent over significant decisions, and therefore the less likely it would be for an entity to be jointly controlled by those investors. The ASC definition does allow entities and individual shareholders to hold minority (noncontrolling) ownership interests in a JV, such as public shares issued by a JV entity. In practical terms, this would mean a large number of individual shareholders could own a small percentage of an entity (likely to be considered passive interests) without precluding the entity from meeting the ASC JV definition (that is, as long as the remaining venturers hold joint control over the entity).

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2.2.4 Operated for the mutual benefit of investors (venturers)

The operations of the JV are required to be for the mutual benefit of the venturers. This does not mean that that each of the venturers needs to benefit equally for the entity to be a JV. However, the fact that one venturer may receive more or substantially all the benefits (or rewards) from a JV's operations should be scrutinized, given the notion of joint control discussed in Section 2.2.3.

2.2.5 Purpose of the JV

As noted in Section 2.2.1, the SEC staff have previously remarked on the "purpose" characteristic as one of the required characteristics of a JV. The ASC definition of JV describes the purpose of a JV as a sharing "of 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". In his previously-referenced 2014 speech, Christopher Rogers stated, in part, the following related to the purpose of a JV:

> The staff has seen recent fact patterns where the primary purpose of a transaction is to combine two or more existing operating businesses in an effort to generate synergies such as economies of scale or cost reductions and/or to generate future growth opportunities. In these fact patterns, determining whether the purpose of the transaction is consistent with the definition of a joint venture as described in Topic 323 or whether the substance of the formation transaction is a merger or put together transaction should be accounted for as a business combination under Topic 805 requires a significant amount of judgment.

Therefore, while this characteristic of a JV may appear to be broad or lacking substance as compared to the joint control characteristic, it should be equally evaluated to determine whether the primary purpose of the transaction is consistent with that of the definition of a JV. Additionally, as further explained in Chapter 7, a description of the purpose of a JV is a required disclosure in the reporting period of the formation.

An example of a formation transaction that may be solely related to generating synergies is a combination or merger of existing subsidiaries or divisions of a larger company. While this formation would not meet the definition of a JV due to failing the "purpose" characteristic, it is also important to remember that combinations between entities under common control are excluded from the scope of ASC 805-60 (See Section 2.1).

As explained by Mr. Rogers, if the purpose of a formation transaction is not consistent with that of the JV definition, the transaction may be required to be accounted for as a business combination. The distinction between the accounting for a business combination and the accounting for a JV formation is still relevant despite ASC 805-60 referencing numerous sections of ASC 805 on business combinations. As explained further in Section 5.5, there are still notable differences between the accounting for business combinations and the accounting for JV formations.

3. Venturer accounting at formation date

3.1 Overview

Once the determination has been made that the entity meets the definition of a JV, and therefore should not be consolidated in accordance with ASC 810, investors in a JV will generally account for their investments utilizing the equity method of accounting in accordance with ASC 323-10. The scope of the ASC 805-60 does not address or change this determination or the equity method of accounting.

When an investor is determining both how to measure its initial contribution to a JV and the timing of that measurement, the form of the initial contribution (i.e., cash or non-cash) is a critical factor. For example, when an investor acquires an equity method investment (such as an interest in a JV) for a fixed amount of cash consideration, it follows ASC 323-10 and records its investment at cost at the time the cash is

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transferred to the JV. However, given the purpose and design of a JV discussed in Section 2.2, the contributions from the venturers are usually not as straightforward and include various forms of non-cash consideration, such as businesses, financial assets and non-financial asset groups that may not constitute businesses. Generally, in scenarios in which an investor provides non-cash consideration, the investment is recorded at fair value by the investor.

The following guidance is provided in ASC 323-10 about the initial measurement by a venturer of their investment in a JV.

ASC 323-10-30-2

Except as provided in the following sentence, an investor shall measure an investment in common stock of an investee (including a joint venture) initially at cost in accordance with the guidance in Section 805-50-30. An investor shall initially measure, at fair value, the following:

a. A retained investment in the common stock of an investee (including a joint venture) in a deconsolidation transaction in accordance with paragraphs 810-10-40-3A through 40-5.

b. An investment in the common stock of an investee (including a joint venture) recognized upon the derecognition of a distinct nonfinancial asset or distinct in substance nonfinancial asset in accordance with Subtopic 610-20.

Non-cash contributions, such as businesses and nonfinancial assets, are scoped out of ASC 323-10-30-2 and follow other applicable GAAP. The following table discusses which applicable GAAP venturers should follow depending on the form of the contribution.

Contribution	Applicable derecognition guidance
Business as defined in ASC 805	ASC 810-10, *Consolidation — Overall*
Nonfinancial asset or assets that do not constitute a business	ASC 610-20, *Other Income — Gains and Losses form the Derecognition of Nonfinancial Assets*
Financial assets	ASC 860, *Transfers and Servicing*
Oil and gas mineral rights	ASC 932, *Extractive Activities — Oil and Gas*

When non-cash contributions are utilized to acquire interests in the JV at formation, the venturer will recognize its investment in the JV when the non-cash contributions are determined to be derecognized. The derecognition criteria for these types of contributions are generally focused on the notion of control being transferred, though they differ depending on the type of non-cash contributions. For example:

- Under ASC 810-10, a venturer would deconsolidate a business, and thus recognize an investment in the JV, as of the date the venturer ceases to have a controlling financial interest in the applicable contribution.
- Under ASC 610-20, a venturer would derecognize the nonfinancial assets, and thus recognize an investment in the JV, when it has transferred control of the assets to the counterparty. The analysis of whether control has been transferred to the counterparty is consistent with the criteria in ASC 606, *Revenue from Contracts with Customers,* used to evaluate the time at which a customer obtains control of a promised asset. Refer to GABC Section 9.1 for further analysis regarding transfer of control.

There are commonly other arrangements or transactions at or near the time of a formation that a venturer will need to consider when determining its cost of the investment. For example, there are often transaction costs for the venturer when forming a separate JV entity or contingent consideration arrangements between the venturers and the JV. The accounting by the venturers for those

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considerations are outside the scope of this white paper, though applicable guidance can be found in ASC 323-10.

3.2 Allocating the initial measurement to assets and liabilities (basis differences)

An equity method investment (such as an investment in a JV) is presented on the balance sheet of an investor as a single amount. However, at the time of formation, the venturer is required to allocate the initial measurement of its JV investment (cost) to its proportionate share of the individual assets and liabilities of the venture itself. This required allocation is performed in accordance with the following guidance in ASC 323-10.

Excerpt from ASC 323-10-35-13

A difference between the cost of an investment and the amount of underlying equity in net assets of an investee shall be accounted for as if the investee were a consolidated subsidiary…

ASC 323-10-35-34

The carrying amount of an investment in common stock of an investee that qualifies for the equity method of accounting as described in paragraph 323-10-15-12 may differ from the underlying equity in net assets of the investee. The difference shall affect the determination of the amount of the investor's share of earnings or losses of an investee as if the investee were a consolidated subsidiary. However, if the investor is unable to relate the difference to specific accounts of the investee, the difference shall be recognized as goodwill and not be amortized in accordance with Topic 350.

There may be a difference in the total cost basis of the venturer’s JV investment and its proportional interest in the underlying equity in the net assets recognized by the JV. Generally, this difference is attributable to multiple assets and liabilities of the JV. To attribute the differences appropriately in accordance with the guidance in ASC 323-10-35-13, an investor effectively values the JV as if it has acquired the venture at the date of its contribution. In doing so, it would determine the acquisition (contribution) date fair value of the identifiable assets and liabilities in accordance with ASC 805-20. This required exercise could result in in the venturer identifying additional assets, such as intangibles, that were not recognized prior to the contribution. The resulting fair values from this exercise are then compared with the assets and liabilities recorded in the JV’s financial statements at formation. Any differences between the two amounts are considered basis differences.

Subsequent to the formation, basis differences assigned to the individual assets and liabilities will often affect the investor’s earnings from its investment in the JV. If so, the corresponding increase or decrease should be recorded to the JV investment of the venturer.

There could be instances in which the venturer’s cost of the JV investment exceeds its proportionate share of the fair value of the venturer’s net assets at the formation date. For example, this could happen if the venturer incurred a significant amount of transaction costs or had contingent consideration arrangements with the JV. In these instances, a venturer should assign the excess to what is referred to as equity method goodwill. Before doing so, a venturer should carefully assess whether they have considered all net assets of the JV, including any other intangibles that have not been recorded by the JV. That is, a venturer should make every reasonable attempt to attribute the excess to identifiable assets and liabilities of the venturer before recording “equity method goodwill.” If the venturer’s cost is not correctly attributed to identifiable assets and liabilities, the recording of subsequent earnings from the JV could be misstated since goodwill is generally not amortized.

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Spotlight on change:

One of the primary reasons the FASB issued ASU 2023-05 was to address the diversity in practice surrounding how JVs measure their net assets at formation. Currently, some JVs measure their net assets at fair value at formation, while other JVs initially measure their net assets at the carrying amounts of their investors. In the latter situation, there could be numerous basis differences between the amounts calculated by the venturers in accordance with ASC 323-10 and the amounts recorded in the JV's financial statements. For example, if a JV initially measures its assets and liabilities at the carrying amounts of the investors, then any assets that have appreciated while the investors held it will have a positive basis difference (that is, the venturer's basis measured at fair value will be higher than that of the venture itself).

While the adoption of ASU 2023-05 will not amend the required accounting by the venturers of the JV, the prevalence of basis differences recorded by venturers is expected to significantly decrease. This is due to the change in ASU 2023-05 that at formation, JVs will be required to measure contributed assets and liabilities predominantly at fair value in accordance with ASC 805 (that is, JVs will no longer be allowed to apply a carryover method to contributed assets and liabilities). Therefore, once the ASU is adopted, the venturers and JV will be measuring contributed assets and liabilities at the same basis (predominantly fair value in accordance with ASC 805-20) at formation.

In the Basis for Conclusions of ASU 2023-05, the FASB noted that that an added benefit of the requirements of ASU 2023-05 will be the reduction of equity method basis differences for venturers. Additionally, the FASB noted that JVs may be able to leverage the results from the venturer's measurements for the accounting in the JV financial statements.

4. Determining the formation date

The date that an entity initially meets the definition of JV as defined in the ASC Master Glossary is considered the formation date of the JV. As explained in Section 2.2, judgment is required to determine if and when a legal entity meets the definition. The determination of the formation date is a critical step in the accounting for the JV formation as it represents the date at which all contributions from the venturers will be measured. While ASU 2023-05 does not amend or add any additional interpretive guidance on how to apply the definition of a JV, the ASU does include factors to assist in determining the following:

- Whether multiple arrangements should be accounted for as a single formation transaction
- What arrangements should be part of or separate from the formation

4.1 Multiple arrangements accounted for as a single formation transaction

The determination of the formation date may be a simple exercise if there is one arrangement that governs the formation or if all contributions from the venturers occur on the same date. However, in practice, formations of a JV often comprise multiple contributions from the venturers over a period and determination of the formation date may require significant judgment. For these situations, ASC 805-60-25-4 contains factors to help determine whether the multiple contributions should be accounted for as a single formation transaction. The factors are similar to those utilized in ASC 810-10-40-6 for combining multiple transactions for the sale or derecognition of a business.

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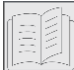


ASC 805-60-25-4

Multiple arrangements may establish the formation of a joint venture and constitute the joint venture formation transaction. Circumstances sometimes indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the multiple arrangements as a single transaction that establishes the formation, a joint venture shall consider the terms and conditions of the arrangements and their economic effects. Any of the following may indicate that the joint venture should account for the multiple arrangements as a single transaction that established the formation of the joint venture:

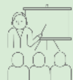
a. The multiple arrangements are entered into at the same time or in contemplation of one another.

b. The multiple arrangements form a single transaction designed to achieve an overall commercial effect.

c. The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.

d. One arrangement considered on its own is not economically justified, but the multiple arrangements are economically justified when considered together.

As explained in ASC 805-60-25-5, if it is determined that multiple arrangements (i.e., various contributions from the venturers) should be accounted for as one single transaction that establishes the JV formation, then each of those contributions should be measured as of the formation date. This may create situations in which there is a timing difference between the recognition date and measurement date.



Example 4-1: Multiple contributions to a JV over a period of time

Entity A establishes a separate legal entity on April 1, 20X1, that they plan to operate with another entity as a JV. On May 1, 20X1, Entity A enters into a JV arrangement with Entity B, and Entity A contributes a business to the separate legal entity while Entity B contributes cash and other fixed assets. Entity B also agrees that it will contribute other assets to the separate legal entity on June 30, 20X1.

Assume it is determined that the separate legal entity meets the definition of a JV on May 1, 20X1, and hence that is the formation date. All contributions by Entity A and Entity B are determined to be part of the JV formation. Entity B contributes the other assets on June 30, 20X1, and measures their fair value for purposes of recording its investment and any resulting gain or loss as of the contribution date in accordance with ASC 610-20.

Despite the various dates of the contributions by the investors, the singular measurement date should be the formation date (the date at which the legal entity meets the definition of a JV). Therefore, the JV should measure all contributions as of May 1, 20X1.

As explained in ASC 805-60-25-3 and highlighted in Example 4-1, a JV should not assume that the date the legal entity is established is the formation date. We also believe that a JV should not assume that the venturer measurement date (i.e., the date the venturer derecognizes their contributed assets) is the same as the formation date. This is primarily because the guidance on derecognition for venturers and the guidance on formation date for a JV focus on different considerations and therefore may not align. The timing of derecognition for venturers is generally determined based on the loss of (or transfer of) control of the contributed or transferred assets (see Section 3.1) while the formation date for a JV is based on when the definition of JV is met. In Example 4-1, if the fair value of the other assets contributed on the venturer derecognition date of June 30, 20X1, had appreciated after the formation date of May 1, 20X1,

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the JV and venturer would have different measurement amounts for the other assets. As explained in Section 3.2, this would create a positive basis difference that the venturer would have to subsequently track and account for in order to appropriately account for its share of the JV's income. Therefore, in circumstances in which it is determined that a JV formation comprises multiple arrangements over a period of time, a venturer should be aware that basis differences could still arise even after adoption of ASU 2023-05.

4.2 Determining which arrangements are part of the formation

At or near the formation date, a JV and its owners (the venturers) may enter into multiple arrangements. For example, the JV may enter into an arrangement to compensate either the venturers or the employees of the venturers for future services. Other potential arrangements could include planned restructuring activities of a business contributed to a JV. In these situations, a JV should apply the existing guidance in ASC 805-10-55-24 through 55-26 on assessing which arrangements are part of the exchange for an acquiree in a business combination to determine which arrangements should be accounted for as part of the JV formation. This guidance includes assessing why the arrangement was entered into, who initiated the arrangement and when the parties entered into the arrangement. See GABC Section 13.1 for additional information on how to apply this guidance.

When a JV issues share-based payment awards to replace awards held by grantees of contributed businesses, the JV must allocate the fair value-based measure determined in accordance with ASC 718, *Compensation—Stock Compensation,* between the preformation vesting and postformation compensation cost. To determine the allocation, the JV should apply the existing guidance in ASC 805-30-30-9 through 30-13, which covers the allocation of share-based replacement awards in a business combination. See GABC Section 13.4 additional details.

In a business combination, the amount allocated to the preformation vesting would be added to the consideration transferred to acquire the target, which would increase the purchase price and affect the measurement of goodwill. However, the accounting for a JV formation does not apply the concept of total consideration transferred to measure total net assets (including goodwill) of the JV (see Chapter 6). Therefore, the FASB provided examples in ASC 805-60-55-2 through 55-14 to illustrate the resulting accounting from applying the applicable ASC 805-*30, Business Combinations — Goodwill or Gain from Bargain Purchase, Including Consideration Transferred,* guidance to the issuance of share-based payment replacement awards in a JV formation. The examples are reproduced below.

Example 4-2: Joint Venture Replacement Share-Based Payment Employee Awards (ASC 805-60-55-2 to 55-14)

On January 1, 20X0, a newly formed corporation with no assets or liabilities, New Venture, receives contributions of a controlling financial interest in Business A (90 percent voting interest) from Venturer 1 and Business B (100 percent voting interest) from Venturer 2 and, in exchange, issues 50 common shares to each Venturer 1 and Venturer 2. Assume that New Venture has no other classes of equity or any other equity instruments outstanding before receiving the contributions. It is determined that New Venture first met the definition of a joint venture on January 1, 20X0. New Venture determines January 1, 20X0, to be its formation date.

In accordance with paragraph 805-60-30-2, but before consideration of any liabilities for share-based payments, New Venture determines that the fair value of the joint venture as a whole is $100 million including a noncontrolling interest (10 percent voting interest) in Business A that is owned by an outside entity. It also determines, in accordance with paragraph 805-60-30-2, that the formation-date fair value of the identifiable assets is $120 million, the fair value of the liabilities is $40 million, and the fair value of the noncontrolling interest in Business A is $5 million.

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Upon formation, New Venture exchanges replacement awards that require one year of postformation vesting for share-based payment awards of Business A for which employees had not yet rendered all of the required services as of the formation date. The fair-value-based measure of both awards (the original awards and the replacement awards) is $20 million at the formation date. When originally granted, the awards of the contributed business had a requisite service period of four years. As of the formation date, the contributed business's employees had rendered two years' service, and they would have been required to render two additional years of service after the formation date for their awards to vest. Accordingly, only a portion of the contributed business's awards is attributable to preformation vesting.

The replacement awards require only one year of postformation vesting. Because employees have already rendered two years of service, the total requisite service period is three years. For simplicity, assume that New Venture estimates that there will be no forfeitures of the replacement share-based payment awards. The portion attributable to preformation vesting equals the fair-value based measure of the contributed business's award ($20 million) multiplied by the ratio of the preformation vesting period (2 years) to the greater of the total service period (3 years) and the original service period of the contributed business's award (4 years). Thus, $10 million ($20 million × 2 ÷ 4 years) is attributable to preformation vesting and, therefore, New Venture's additional paid-in capital upon formation. The remaining $10 million is attributable to postformation vesting and therefore recognized as compensation cost in New Venture's postformation financial statements in accordance with Topic 718 on stock compensation.

New Venture applies the guidance in Topic 718 to determine whether the share-based payments should be classified as liabilities or equity.

Case A: Joint Venture Replacement Share-Based Payment Employee Awards Are Liability Classified

If New Venture determines that the replacement share-based payment awards are classified as liabilities, then total liabilities will equal $50 million ($40 million + $10 million). For simplicity, when taking the share-based payment liabilities into account, the fair value of New Venture as a whole is $90 million ($100 million – $10 million).

New Venture calculates goodwill as follows (in millions), consistent with the guidance in paragraph 805-60-30-2. The formation-date fair value of the joint venture as a whole is equal to the fair value of 100 percent of the joint venture's equity (net assets) immediately following formation (including any noncontrolling interest in the net assets recognized by the joint venture).

Fair value of New Venture as a whole (including $5 noncontrolling interest)	$ 90
Less: Net fair value of identifiable assets and liabilities recognized ($120 assets - $50 liabilities)	(70)
Goodwill recognized by New Venture at formation date	**$ 20**

New Venture calculates additional paid-in capital as follows (in millions).

Net assets recognized by New Venture, excluding share-based payment liabilities ($120 identifiable assets – $40 liabilities + $20 goodwill)	$ 100
Less: The fair value of noncontrolling interest in business contributed to New Venture	(5)
Less: The fair value of preformation vesting replacement share-based payments classified as a liability	$10
Additional paid-in capital recognized by New Venture at the formation date	**$ 85**

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New Venture records the following entry at the formation date (in millions).

Identifiable assets recognized	$ 120	
Goodwill	20	
Liabilities recognized		$ 40
Noncontrolling interest		5
Share-based payment liability (preformation vesting)		10
Additional paid-in capital		85

Case B: Joint Venture Replacement Share-Based Payment Employee Awards Are Equity Classified

If New Venture determines that the replacement share-based payment awards are classified as equity, then total liabilities will equal $40 million and the fair value of New Venture as a whole is $100 million.

New Venture calculates goodwill as follows (in millions), consistent with the guidance in paragraph 805-60-30-2. The formation-date fair value of the joint venture as a whole is equal to the fair value of 100 percent of the joint venture's equity (net assets) immediately following formation (including any noncontrolling interest in the net assets recognized by the joint venture).

Fair value of New Venture as a whole (including $5 noncontrolling interest)	$ 100
Less: Net fair value of identifiable assets and liabilities recognized ($120 assets - $40 liabilities)	(80)
Goodwill recognized by New Venture at formation date	**$ 20**

New Venture calculates additional paid-in capital, excluding additional paid-in capital attributable to share-based payments, as follows (in millions).

Net assets recognized by New Venture, excluding share-based payment liabilities ($120 identifiable assets – $40 liabilities + $20 goodwill)	$ 100
Less: The fair value of noncontrolling interest in business contributed to New Venture	(5)
Less: The fair value of preformation vesting replacement share-based payments classified as equity	$10
Additional paid-in capital recognized by New Venture at the formation date	**$ 85**

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New Venture records the following entry at the formation date (in millions).

Identifiable assets recognized	$ 120	
Goodwill	20	
Liabilities recognized		$ 40
Noncontrolling interest		5
Additional paid-in capital – shared-based payments (preformation vesting)		10
Additional paid-in capital		85

5. Recognition and measurement at the formation date

5.1 Overview of recognition and measurement principles in ASC 805-60

The formation of a JV is determined to be the creation of a new reporting entity where none of the assets or businesses contributed have survived the transaction. As a result, ASC 805-60 requires a newly formed JV to apply a new basis of accounting for its identifiable assets and liabilities and any noncontrolling interest, in accordance with ASC 805-20. That is, a JV will initially recognize contributed assets and liabilities and measure them at fair value at the formation date with certain exceptions that are consistent with those in the business combinations guidance. The exceptions to the general recognition principle and fair value measurement principle in ASC 805-20 include items such as contract assets and contract liabilities, leases, income taxes, certain contingencies, and pension and postretirement benefits. See further discussion of the recognition and measurement of acquired assets and liabilities in GABC Chapter 10 and the exceptions to the general principles in Chapter 11.

While a JV will generally be able to apply the guidance in ASC 805-20 to contributed assets and liabilities, ASC 805-60 includes additional guidance on contingent payment arrangements and transfers of financial assets to assist the JV in applying the principles of business combination to a JV formation.

5.1.1 Contingent payment arrangements

The formation of a JV may include a contingent consideration arrangement between the venture and the venturers. For instance, a JV might promise to issue additional payments to a venturer contingent upon the performance of a contributed set of assets or a business. This type of transaction should first be assessed to determine if it should be recognized separately from the JV as addressed in Section 4.2 (for example, as postformation compensation cost). If determined to be part of the formation, an acquirer in a business combination would normally follow the specific contingent consideration arrangement guidance under ASC 805-30. However, in accordance with ASC 805-60-30-6, a JV should initially measure any contingent payment arrangements based on the measurement guidance in ASC 805-20 on assets or liabilities arising from contingencies. In paragraph BC59 of the Basis for Conclusions of ASU 2023-05, the FASB observed that because a JV's total net assets (including goodwill) are measured on the basis of the fair value of the JV as whole upon formation instead of consideration transferred, it may be challenging to identify contingent consideration arrangements as they are defined in ASC 805-30. As noted previously, one of the exceptions to the general fair value measurement principle in ASC 805-20 is for certain assets or liabilities arising from contingencies. See GABC Section 11.2 for additional guidance on assets and liabilities arising from contingencies.

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5.1.2 Transfers of financial assets

ASC 805-60-25-15

If a venturer transfers financial assets that are within the scope of Subtopic 860-10 to the joint venture upon formation, then the joint venture shall determine whether the transfer results in the recognition of the transferred financial assets by the joint venture by applying the guidance in Subtopic 860-10.

ASC 860 addresses whether a transfer of financial assets represents a sale or a secured borrowing. Pursuant to ASC 805-60-25-15, a JV that receives financial assets from a venturer through a transfer within the scope of ASC 860-10, *Transfers and Servicing — Overall*, must determine whether the transfer results in recognition of those assets by applying the guidance in ASC 860-10.

Paragraph BC73 of ASU 2023-05 states, in part, the following related to the objective of ASC 805-60-25-15:

> the objective of the amendments in this Update on transfers of financial assets is to align the accounting by a joint venture for financial assets transferred to the joint venture from the venturers with the accounting by the venturers that transferred those financial assets. Because of this, the amendments are not meant to definitively conclude that financial assets transferred to a joint venture at formation are either a secured borrowing or a sale. Moreover, the amendments are not intended to change how the venturers would account for a transfer of financial assets to the joint venture but rather to align the joint venture's accounting with the venturers' accounting. The Board notes that Subtopic 860-10 is based on the concept of control and that the venturers and the joint venture will have to evaluate the conditions as they would with any other transfer of financial assets in accordance with Topic 860.

ASC 860-10-40-5 sets forth the conditions that must be met for a transfer of an entire financial asset, a group of entire financial assets or a participating interest in an entire financial asset to be treated as a sale (i.e., to be derecognized by the transferor (e.g., the venturer) and recognized by the transferee (e.g., the JV)). Derecognition of financial assets occurs when control over the financial asset has been surrendered. In general, control over financial assets is surrendered when all of the following conditions are met:

- The transferred financial assets are legally isolated from the transferor.
- Each transferee has the right to pledge or exchange the transferred financial assets.
- The transferor does not maintain effective control over the transferred financial assets.

5.2 Income taxes

As noted in Section 5.1, income taxes are one of the exceptions to the general recognition and measurement principles in ASC 805-20. As such, deferred tax assets and liabilities are recognized and measured in accordance with ASC 740, *Income Taxes*. If the JV is a taxable entity, it may need to assess whether the tax basis of the noncash assets contributed and measured at fair value for accounting purposes were also stepped up to fair value or carried over at the investor's basis. If carried over at the investor's basis, the book-tax basis differences would require the recording of deferred taxes at the contribution date. Refer to GABC Section 11.4 for additional information on the accounting for income taxes in a business combination.

5.3 Measurement period adjustments

ASC 805-60 allows a JV to apply the measurement period guidance in ASC 805-10-25-13 through 25-19 if the initial accounting for a JV information is incomplete as of the end of the reporting period in which the

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formation occurs. Accordingly, JVs have up to one year from the formation date to obtain the information necessary to identify any additional assets or liabilities or adjust the measurement of any items marked as provisional. See Chapter 7 for the required disclosures in these situations.

See GABC Section 12.7 for further information on how to apply the measurement period guidance in ASC 805.

5.4 Private companies

A JV that meets the definition of a private company can elect to apply the available private-company alternatives when accounting for the formation, such as those related to the recognition of certain intangible assets and the subsequent accounting for goodwill.

See GABC Chapter 17 (intangible assets alternative) and Chapter 18 (goodwill alternative) for further details on how to apply the available private-company alternatives.

5.5 Notable differences between the accounting for business combinations and JV formations

While the outcome of ASC 805-60 when applied to a JV formation is broadly consistent with the accounting outcome that would result from treating the JV as the acquirer in a business combination, there are several differences between the accounting for a business combination under ASC 805-20 and the accounting for a JV formation under ASC 805-60. The table below highlights some of the more notable differences.

Difference	JV Formation Treatment
Identifying an acquirer	An acquirer does not need to be identified in a JV formation and the JV itself is not identified as the acquirer. In paragraphs BC32 and BC33 of the Basis for Conclusions of ASU 2023-05, the FASB explained that the identification of the acquirer is inconsistent with the accounting requirements for venturers, particularly in situations in which a newly formed entity is utilized or two existing businesses are merged to form a JV.
Acquisition-related costs and pre-existing relationships	Since a JV is considered to be the creation of a new reporting entity at the formation date, it is prohibited from applying the guidance in ASC 805-10, *Business Combinations — Overall,* related to settling a pre-existing relationship and the accounting for acquisition-related costs.
Entities that do not meet the definition of a business	A JV should apply the guidance in ASC 805-20 regardless of whether the JV meets the definition of a business in ASC 805. Therefore, a JV that is not a business will, in certain circumstances, recognize an intangible asset for in-process research and development (IPR&D) and goodwill, both of which would only be recognized in ASC 805 for acquisitions of entities that meet the definition of a business.
Contingent payment arrangements	As noted in paragraph BC59 of the Basis or Conclusions of ASU 2023-05, the FASB observed that it may be challenging to identify contingent consideration arrangements as defined in ASC 805-30 in a JV formation because a JV does not measure the fair value of its total net assets (including goodwill) at formation on the basis of total consideration transferred (see Chapter 6). Therefore, to avoid those challenges, a JV is required to recognize any contingent consideration as either a liability or asset at formation in accordance with ASC 805-20. As a result of this treatment, the related asset or liability for contingent consideration in a JV

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Difference	JV Formation Treatment
	may not initially be measured at fair value or subsequently measured at fair value (as it would be in a business combination under ASC 805-30).
Replacement share-based payment awards	In both a business combination and JV formation, the amount allocated to pre-formation vesting for the replacement share-based payment awards may be classified as either equity or a liability depending on certain factors. In a business combination, the amount corresponding to the liability or equity recognized is accounted for as additional consideration transferred and affects the measurement of goodwill for the acquired entity. In a JV formation, these amounts are accounted for as a reallocation of additional paid-in capital, as shown in Example 4-2, and do not affect the goodwill or total equity of the JV.

6. JV formation goodwill

Goodwill is recognized and measured as the excess of the fair value of 100% of the JV's equity immediately following formation (including any noncontrolling interest) less the fair value of the net identifiable assets contributed by the venturers at the formation date. The goodwill of the JV should not be confused with equity method goodwill recognized by the venturers (see Section 3.2).

There may be instances in which the fair value of the JV as a whole immediately following formation is less than the net identifiable assets contributed by the venturers (for example, if a market participant views the contributed businesses as more valuable operated separately). In these scenarios, the "negative goodwill" should be recognized as an adjustment to the equity of the JV. This is in contrast to a bargain purchase gain recognized by acquirers for similar situations in a business combination. In paragraph BC50 of the Basis for Conclusions of ASU 2023-05, the FASB explained that there is a low likelihood of having negative goodwill in a JV formation. Therefore, we believe that in these situations, similar to when a bargain purchase gain is recognized, the JV should perform a thorough self-review of its initial formation accounting to ensure that the fair value of identifiable assets was appropriately recognized and measured.

As noted in Section 5.5, goodwill should be calculated and measured for a JV at formation regardless of whether it meets the definition of a business. However, the FASB explained in the paragraph BC48 of the Basis for Conclusions of the ASU that it would be unusual for a JV that is not a business to recognize a significant amount of goodwill. If that is the case, a JV should revisit the initial accounting in these situations to ensure the venture has correctly identified all contributed net assets and has all the available information necessary to measure them.

As noted in Section 5.4, a JV that is a private company may apply the accounting alternatives related to the recognition of certain intangible assets and the subsequent accounting for goodwill.

7. Disclosures

ASC 805-60-50 requires a JV to disclose information about the nature and financial effect of the JV formation in the period in which the formation date occurs, including information about:

- The formation date
- A description of the purpose for the which the JV was formed
- The formation-date fair value of the JV as a whole
- A description of the assets and liabilities recognized at the formation date

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- The amounts recognized for each major class of assets and liabilities (either presented on the face of the financial statements or disclosed in the notes)
- A qualitative description of the factors that make up any goodwill recognized

These disclosures are similar to those required in a business combination, though they are not nearly as extensive. A JV that applies the measurement period guidance discussed in Section 5.3 also needs to disclose:

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

RSM COMMENTARY: The purpose for which the JV was formed is not only a required disclosure, but also a defining characteristic of a JV. Companies should ensure that the description of the purpose of the JV disclosed in the financial statements is consistent with that of the JV definition in the ASC Master Glossary. If not, it would call into question whether the legal entity being accounted for as a JV meets the accounting definition and whether it should be included in the scope of ASC 805-60.

8. Transition and effective date

ASU 2023-05 is effective for all JV formations (both public and private JV entities) with a formation date on or after January 1, 2025. Early adoption of the guidance is allowed in any interim or annual period in which financial statements have not yet been issued (or made available for issuance).

A JV formed before the effective date of the amendments is permitted, but not required, to apply the amendments retrospectively if the JV has sufficient information to do so. This option would require a JV to apply the new guidance at the formation date, determine the fair values of the contributed assets and liabilities as of that date, and adjust all periods subsequent to formation to reflect the changes made to the assets and liabilities at the formation date.

A JV that elects to apply the amendments retrospectively is required to apply the relevant business combinations guidance as it existed at the formation date of the JV. That is, a JV formed in 2017 would be required to apply ASC 805-20 as it existed in 2017. There have been recent amendments to the guidance in ASC 805-20. For example, if a JV were to apply ASC 805-20 as it existed in 2017, there would be no fair value measurement exception for acquired contract assets and contract liabilities from contracts with customers.

A JV that elects to apply the new guidance retrospectively is also required to provide the transition disclosures in ASC 250-10, *Accounting Changes and Error Corrections—Overall.*

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