To our clients and other friends

Companies often form new arrangements and strategic ventures with other parties to manage risk, enter new markets and perform other similar activities. Some of these transactions may be loosely referred to as “joint ventures,” which is a defined term in US GAAP that has important accounting consequences. US GAAP currently treats certain transactions involving joint ventures differently from transactions involving other businesses and joint arrangements.

There is no authoritative guidance related to the accounting applied by a joint venture when recognizing noncash assets contributed at its formation. In the past, joint ventures generally applied carryover basis to these assets, except in limited circumstances. This accounting followed from public statements made by the Securities and Exchange Commission (SEC) staff. Practice has evolved in recent years, however, as a result of changes to the accounting guidance applied by the venturers in these transactions. The SEC staff has stated that the use of fair value in these transactions now may be appropriate in more circumstances, but also has acknowledged the lack of guidance in US GAAP on the accounting for these transactions, which has resulted in diversity in practice.

This Financial reporting developments (FRD) publication is designed to help you properly identify joint ventures and understand the related accounting issues. It addresses the latest guidance and views on the accounting applied by both a joint venture and its venturers for noncash assets contributed at formation. This publication reflects our current understanding of this accounting based on public statements by the SEC staff and our experience with financial statement preparers. This edition has been updated to reflect a recent statement made by the SEC staff. These changes are summarized in Appendix E.

This publication has not been updated for the issuance of ASU 2015-02, Amendments to the Consolidation Analysis, which changed aspects of both the variable interest entity and the voting model. ASU 2015-02 is effective for annual and interim periods beginning after 15 December 2015. For nonpublic business entities, it is effective for annual periods beginning after 15 December 2016, and interim periods beginning after 15 December 2017. See our Technical line publication, New consolidation guidance will require many entities to re-evaluate their conclusions, for more information.

In June 2015, the FASB issued a proposal to simplify the equity method of accounting in two respects. First, the proposal would eliminate the requirement that an investor account for the difference between the cost of an investment and the amount of underlying equity in net assets of an investee (referred to as “basis difference”) as if the investee were a consolidated subsidiary. The proposal also would eliminate the requirement that an entity retrospectively adopt the equity method of accounting if an investment that was previously accounted for on other than the equity method (e.g., cost method) qualifies for use of the equity method due to an increase in the level of ownership interest. See our To the Point, FASB proposes simplifying equity method accounting. We encourage readers to monitor developments in this area.

Practice continues to evolve and the views presented in this publication related to the accounting by the joint venture at formation could change after its release. Readers should monitor developments in this area closely.

Ernst & Young LLP

July 2015
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Notice to readers:

This publication includes excerpts from and references to the FASB Accounting Standards Codification (the Codification or ASC). The Codification uses a hierarchy that includes Topics, Subtopics, Sections and Paragraphs. Each Topic includes an Overall Subtopic that generally includes pervasive guidance for the topic and additional Subtopics, as needed, with incremental or unique guidance. Each Subtopic includes Sections that in turn include numbered Paragraphs. Thus, a Codification reference includes the Topic (XXX), Subtopic (YY), Section (ZZ) and Paragraph (PP).

Throughout this publication references to guidance in the codification are shown using these reference numbers. References are also made to certain pre-codification standards (and specific sections or paragraphs of pre-Codification standards) in situations in which the content being discussed is excluded from the Codification.

This publication has been carefully prepared but it necessarily contains information in summary form and is therefore intended for general guidance only; it is not intended to be a substitute for detailed research or the exercise of professional judgment. The information presented in this publication should not be construed as legal, tax, accounting or any other professional advice or service. Ernst & Young LLP can accept no responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. You should consult with Ernst & Young LLP or other professional advisors familiar with your particular factual situation for advice concerning specific audit, tax or other matters before making any decisions.

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1 Introduction to joint ventures

1.1 Overview

Joint ventures are entities whose operations and activities are jointly controlled by a group of equity investors, which are referred to as “venturers.” The term “joint venture” may be applied loosely in practice to arrangements that may not meet the accounting definition. Properly identifying a joint venture is important because US GAAP currently treats certain transactions involving joint ventures differently from transactions involving other businesses and joint arrangements.

Among other differences, joint ventures receive unique treatment with respect to one of the criteria for applying the business scope exception to the Variable Interest Model in ASC 810. Additionally, ASC 805 and ASC 845 exclude the formation of a joint venture and transfers of nonmonetary assets between a joint venture and its owners from their scope, respectively. An investment in a corporate joint venture may also qualify for unique income tax accounting considerations.

To meet the definition of a joint venture, we believe an arrangement must have all of the following characteristics:

- The arrangement must be organized within a separate legal entity
- The entity must be under the joint control of the venturers
- The venturers must be able to exercise joint control of the entity through their equity investments

Before Statement 160 was issued in December 2007 (codified in ASC 810), both the venturers and the joint venture generally applied carryover basis accounting when recognizing transactions involving the exchange of noncash assets for equity at formation, except in limited circumstances. This accounting followed from interpretations in practice of public statements made by the SEC staff because there was no authoritative guidance for these transactions.

The SEC staff stated that venturers generally should recognize their equity interests at carryover basis (i.e., no gain recognition) upon the formation of a joint venture because the staff did not view the receipt of equity by the venturers as a culmination of the earnings process relative to the contributed assets. When the venturers also received cash in these transactions, the SEC staff believed gain recognition may be appropriate, provided certain conditions were met. The gain recognized in these circumstances was generally limited by the amount of cash exchanged. It was further limited to the portion attributable to other venturers.

There also was an understanding in practice that the SEC staff generally required joint ventures to recognize contributed assets on a carryover basis. This may have been because the SEC staff was concerned about whether there was an objective way for the joint venture to measure the fair value of the contributed assets. There was an understanding that the SEC staff would only support the use of fair value when certain conditions were met, including when fair value was supported by the contribution of an equal amount of cash that either remained in the joint venture or was used by the joint venture in

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1 For example, in some industries such as oil and gas, entities form tax partnerships, but not legal partnerships, to conduct exploration on individual properties. Because these tax partnerships are not separate legal entities, they would not qualify as joint ventures. See Chapter 2 for further discussion of this and other joint venture characteristics.

transactions with parties other than the venturers.\(^3\)

Practice has evolved in recent years, however, in response to changes in the accounting guidance applied by venturers in these transactions. Following the derecognition and deconsolidation guidance originally issued as a part of Statement 160, a venturer now initially recognizes an equity interest in a joint venture at fair value upon the transfer of a subsidiary or a group of assets meeting the definition of a business (with certain exceptions). This generally results in a venturer recognizing a gain at the formation of a joint venture, which is a significant change from historical practice.

The conceptual basis for the accounting in ASC 810 is that the exchange of a business for a noncontrolling equity investment results in a loss of control over the business. The FASB concluded this is a significant economic event that changes the nature of the retained investment in that business. The FASB believes this is a realization event and, therefore, the retained equity investment is measured at fair value, with gains (or losses) recognized in earnings.

Although there has been no guidance issued related to the recognition basis applied by a joint venture for contributed noncash assets, the SEC staff stated publicly in 2009\(^4\) that the use of fair value may be appropriate in more circumstances when recognizing contributed assets that meet the definition of a business. The SEC staff stated that the determination of whether fair value is an appropriate basis will depend on an evaluation of the facts and circumstances and an evaluation of whether a new basis of accounting results in more decision-useful information for the financial statement users.

Practice in this area is evolving in light of this speech as well as the increased use of fair value measurements in financial statements.

This publication provides interpretive guidance related to identifying joint ventures and to the accounting applied by a joint venture and its venturers at formation. With respect to the accounting by the joint venture, this publication presents three acceptable views when applying a fair value approach. The views presented in this publication could change and readers should monitor developments in this area closely.

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\(^3\) This understanding, cited in Issue Summary No. 1 to EITF Issue 98-4 (see section 3.1.1 for an excerpt), is consistent with statements made by members of the SEC staff in response to specific joint venture fact patterns, as described in the publicly available minutes of meetings of certain AICPA committees in November 1988, June 1989, September 1991 and December 1991.

\(^4\) Statement made by Josh S. Forgione, SEC staff member, 7 December 2009. See section 3.1.2 for an excerpt from the speech.
Identifying a joint venture

Overview

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. ASU 2015-02 eliminates the presumption in the voting model that a general partner controls a limited partnership or similar entity and also changes the variable interest entity model. For public business entities, ASU 2015-02 is effective for annual and interim periods beginning after 15 December 2015. For nonpublic business entities, it is effective for annual periods beginning after 15 December 2016, and interim periods beginning after 15 December 2017. Early adoption is permitted, including adoption in an interim period. See our Technical line publication, New consolidation guidance will require many entities to re-evaluate their conclusions, for more information. This publication has not been updated to reflect the issuance of ASU 2015-02.

Excerpt from Accounting Standards Codification

Investments – Equity Method and Joint Ventures – Overall

Glossary

323-10-20

Corporate Joint Venture

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.

Investments – Equity Method and Joint Ventures – Partnerships, Joint Ventures, and Limited Liability Entities

Scope and Scope Exceptions

323-30-15-3

Although Subtopic 323-10 applies only to investments in common stock of corporations and does not cover investments in partnerships and unincorporated joint ventures (also called undivided interests in ventures), many of the provisions of that Subtopic would be appropriate in accounting for investments in these unincorporated entities as discussed within this Subtopic.
Determining whether an arrangement meets the definition of a joint venture is important. It could affect the accounting applied by the parties to the arrangement as well as the accounting applied by the separate reporting entity that may be formed as part of the arrangement. However, the term “joint venture” is applied loosely in practice and may appear in legal documents and public statements by management, which may result in arrangements being improperly identified as joint ventures.

ASC 323-10-20 provides the US GAAP definition of a joint venture. While the definition focuses on a corporate joint venture, entities that meet the definition of a joint venture may be organized in a variety of legal forms. In addition to the corporate form, partnerships and individual interests may also be used to organize a joint venture, as contemplated by ASC 323-30-15-3.

The definition in ASC 323-10-20 provides a number of characteristics that are generally present in joint ventures. We believe that to meet the definition of a joint venture, an arrangement must have all of the following characteristics:

- The arrangement must be organized within a separate legal entity
- The entity must be under the joint control of the venturers
- The venturers must be able to exercise joint control of the entity through their equity investments

Some may mistakenly believe joint control is the single, defining characteristic of a joint venture. However, the SEC staff has stated that it would object to a conclusion that joint control is the only defining characteristic of a joint venture. Rather, the SEC staff has stated that each of the characteristics in the definition of a joint venture in ASC 323 should be met for an entity to be a joint venture. As described in ASC 323-10-20, this means that the purpose of the entity should be 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. Therefore, we believe each of the three characteristics listed above must be present for an arrangement to be considered a joint venture for accounting purposes.

The SEC staff reiterated that when two or more existing operating businesses are combined to produce synergies, reduce costs or generate growth opportunities, determining whether the combined entity

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5 See ASC 845-10-S99-2 and Remarks by Christopher F. Rogers, Professional Accounting Fellow, Office of Chief Accountant at the 2014 AICPA National Conference on Current SEC and PCAOB Developments, 8 December 2014.
qualifies as a joint venture may require significant judgment. In these situations, the SEC staff has observed diversity in practice that the staff believes is due to the lack of guidance and the inherent subjectivity of this determination. As a result, the SEC staff encouraged registrants to consult with SEC’s Office of Chief Accountant about their conclusions related to joint venture formation transactions. Ultimately, determining whether an entity is a joint venture will be based on individual facts and circumstances. See Section 3.1.2, Recent views expressed by the SEC staff, for further guidance.

The following flowchart provides an overview on how to identify a joint venture.

**Illustration 2-1: Framework for identifying a joint venture**

1. **Investment in an entity?**
   - Yes: See Section 2.1.1
   - No: Follow other US GAAP.

2. **Result in a controlling financial interest?**
   - Yes: Follow ASC 810-10 (or applicable guidance, as required).
   - No: See Section 2.3

3. **Is the entity under the joint control of the venturers?**
   - No: Not a joint venture. Apply other GAAP (which could include equity method).
   - Yes: See Section 2.4

4. **Joint control exercised through equity instruments?**
   - No: Follow other US GAAP.
   - Yes: Entity is a joint venture

Illustration 2-2 provides an example of a simple joint venture arrangement.

**Illustration 2-2: Evaluating whether a corporation is a joint venture**

**Facts**

Assume Companies A and B each contribute businesses into a newly formed corporation. Companies A and B each have a 50% equity interest and appoint two representatives to a four-member board of directors. All significant decisions require the unanimous consent of the board members. The companies exercise control exclusively through the rights granted via their equity interests. The companies are not related parties.

**Analysis**

Based on the facts provided, the entity is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers and the venturers exercise joint control through their equity investments.

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1 The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).
Illustration 2-3 provides an example of a partnership that is a joint venture.

<table>
<thead>
<tr>
<th>Illustration 2-3: Evaluating whether a partnership is a joint venture</th>
</tr>
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<tbody>
<tr>
<td><strong>Facts</strong></td>
</tr>
<tr>
<td>Assume a partnership is established in which the general partner has a 3% interest and limited partners A and B have a 50% and 47% interest, respectively. The limited partners A and B have veto rights that, if exercised, would allow them to block the general partner from making any significant decision without their consent. These limited partner rights effectively require unanimous consent by the general partner and limited partners over the significant decisions of the entity. The companies exercise control exclusively through the rights granted via their equity interests. The companies are not related parties.</td>
</tr>
<tr>
<td><strong>Analysis</strong>¹</td>
</tr>
<tr>
<td>Based on the facts provided, the entity is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers and the venturers exercise joint control through their equity investments. The entity would not be a joint venture if, for example, only one of the limited partners had veto rights, if the veto rights of the limited partners related to only some (but not all) of the significant decisions or if the limited partners could not exercise their veto rights unless they voted together. Joint control requires the unanimous consent of all of the venturers over all significant decisions. Unanimous consent only exists when any individual venturer can prevent any other venturer or group of venturers from making significant decisions without its consent (e.g., via substantive approval or veto rights).</td>
</tr>
</tbody>
</table>

¹ The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

2.1.1 Applying the Variable Interest Model and the Voting Model to joint ventures

<table>
<thead>
<tr>
<th>Excerpt from Accounting Standards Codification</th>
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<tr>
<td><strong>Consolidation – Overall</strong></td>
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<tr>
<td><strong>Scope and Scope Exceptions</strong></td>
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<tr>
<td><strong>810-10-15-3</strong></td>
</tr>
<tr>
<td>All reporting entities shall apply the guidance in the Consolidation Topic to determine whether and how to consolidate another entity and apply the applicable Subsection as follows:</td>
</tr>
<tr>
<td>a. If the reporting entity is within the scope of the Variable Interest Entities Subsections, it should first apply the guidance in those Subsections.</td>
</tr>
<tr>
<td>b. If the reporting entity has an investment in another entity that is not determined to be a VIE, the reporting entity should use the guidance in the General Subsections to determine whether that interest constitutes a controlling financial interest. Paragraph 810-10-15-8 states that the usual condition for a controlling financial interest is ownership of a majority voting interest, directly or indirectly, of more than 50 percent of the outstanding voting shares. Noncontrolling rights may prevent the owner of more than 50 percent of the voting shares from having a controlling financial interest.</td>
</tr>
<tr>
<td><strong>810-10-15-4</strong></td>
</tr>
<tr>
<td>All legal entities are subject to this Topic’s evaluation guidance for consolidation by a reporting entity, with specific qualifications and exceptions noted below.</td>
</tr>
</tbody>
</table>
Identifying a joint venture

810-10-15-17

The following exceptions to the Variable Interest Entities Subsections apply to all legal entities in addition to the exceptions listed in paragraph 810-10-15-12:

d. A legal entity that is deemed to be a **business** need not be evaluated by a reporting entity to determine if the legal entity is a VIE under the requirements of the Variable Interest Entities Subsections unless any of the following conditions exist (however, for legal entities that are excluded by this provision, other generally accepted accounting principles [GAAP] should be applied):

1. **The reporting entity, its related parties** (all parties identified in paragraph 810-10-25-43, except for de facto agents under paragraph 810-10-25-43(d)), or both participated significantly in the design or redesign of the legal entity. However, this condition does not apply if the legal entity is an operating joint venture under joint control of the reporting entity and one or more independent parties or a franchisee.

2. **The legal entity is designed so that substantially all of its activities either involve or are conducted on behalf of the reporting entity and its related parties.**

3. **The reporting entity and its related parties provide more than half of the total of the equity, subordinated debt, and other forms of subordinated financial support to the legal entity based on an analysis of the fair values of the interests in the legal entity.**

4. **The activities of the legal entity are primarily related to securitizations or other forms of asset-backed financings or single-lessee leasing arrangements.**

Evaluating whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by one of its venturers. There are two primary consolidation models under US GAAP: (1) the Variable Interest Model, and (2) the Voting Model (both are contained in ASC 810). The Variable Interest Model applies to an entity in which the equity does not have characteristics of a controlling financial interest. An entity that is not a variable interest entity is often referred to as a voting interest entity.

The evaluation of whether an entity should be consolidated always should begin by considering the Variable Interest Model. This model is designed to enable an enterprise to determine whether an entity should be evaluated for consolidation based on variable interests or voting interests. The Variable Interest Model applies to all legal entities, including corporations, partnerships, limited liability companies and trusts.

The Voting Model applies only if an entity is not within the scope of the Variable Interest Model or is determined not to be a variable interest entity. Certain joint ventures may meet the business scope exception to the Variable Interest Model. However, since not all entities that may be joint ventures will meet the business scope exception, the Variable Interest Model may need to be applied to determine whether the entity is a variable interest entity and whether the entity should be consolidated by any of its variable interest holders.

A variable interest entity can still be a joint venture that would not be consolidated by its variable interest holders under the Variable Interest Model. Nonetheless, in these circumstances, additional disclosures may be required (see Chapter 5). Our FRD publication, *Consolidation and the Variable Interest Model*, provides further interpretive guidance on applying the Variable Interest Model, including applying the business scope exception to the model.

Because the business scope exception to the Variable Interest Model includes a provision specifically for joint ventures, a venturer may need to determine whether an entity is a joint venture prior to applying the Variable Interest Model. Therefore, we believe this scope exception implies that all joint ventures have certain characteristics that are similar to voting interest entities, including the exercise of joint control by the venturers exclusively through their equity investments (see Section 2.1 for a discussion of the characteristics we believe must be present for an entity to meet the definition of a joint venture).
The Voting Model generally can be subdivided into two categories: (1) consolidation of corporations, and (2) consolidation of limited partnerships and similar entities. Consolidation of corporations is generally based upon whether an enterprise owns more than 50% of the outstanding voting shares of an entity, with certain exceptions. Consolidation based on majority voting interest may apply to legal entities other than corporations. However, we use the term “corporation” to distinguish from the approach applied to limited partnerships and similar entities.

For limited partnerships and similar entities (e.g., limited liability companies) that are not variable interest entities, there is a presumption that the general partner (or its equivalent) controls the entity, regardless of ownership percentage, unless the presumption can be overcome. The general partner does not control a limited partnership if the limited partners have either (1) the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove or “kick out” the general partner without cause or (2) substantive participating rights.

The guidance provided in this chapter describes the characteristics of a joint venture, as defined in ASC 323. We generally believe the characteristics described in this chapter would be present in joint ventures that are either variable interest entities or voting interest entities. We have highlighted circumstances when either of the two consolidation models have unique considerations that may affect the conclusion of whether an entity is a joint venture.

### 2.2 Joint ventures must be organized as separate legal entities

**Excerpt from Accounting Standards Codification**

**Consolidation – Overall**

**Glossary**

**810-10-20**

**Legal entity**

Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

To be a joint venture, an arrangement must be organized as a separate legal entity that carries on activities with its own assets and liabilities. This characteristic provides the foundation for the remaining characteristics of a joint venture. That is, a joint venture must have a separate, legal decision-making identity so that the activities are capable of being jointly controlled by the venturers through their equity investments.

Corporations, partnerships, limited-liability companies, other unincorporated legal entities and trusts are examples of structures that meet the definition of a legal entity. Determining whether a structure meets the definition of a legal entity requires the consideration of the facts and circumstances and may require the assistance of legal counsel. Our FRD publication, *Consolidation and the Variable Interest Model*, provides further interpretative guidance on identifying legal entities.

It is common in certain industries for entities to establish collaborative contractual relationships without forming a separate legal entity. These arrangements may be used for marketing purposes or to develop and commercialize intellectual property, among other activities, and they are sometimes called “virtual joint ventures.” In these arrangements, each company retains its own assets and continues to conduct its activities separately from the remaining entities. These arrangements do not constitute joint ventures and should be accounted for as collaborative arrangements in accordance with ASC 808.
Illustration 2-4: Evaluating whether a collaborative arrangement is a joint venture

Facts
Two companies enter into a joint marketing arrangement that both publicly refer to as a “joint venture.” Each company agrees to collaboratively produce marketing materials and use their existing sales channels to market the products and services of the other. Each company contractually agrees to share a specified percentage of the revenues received from the sale of products and services made under the joint marketing arrangement. However, no separate entity is established to conduct the joint marketing activities and each company retains its own assets and conducts its activities separately from the other. The companies are not related parties.

Analysis
Based on the facts provided, the arrangement is not a joint venture. While the companies have contractually agreed to share control over the arrangement, no separate entity has been established to house the related assets and conduct the joint marketing activities. Therefore, the activities would not be capable of being jointly controlled by the venturers through their equity investments. Refer to ASC 808 for guidance on accounting for these arrangements.

---

Excerpt from Accounting Standards Codification

Business Combinations — Overall

Glossary
805-10-20

Business
An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

Joint ventures often meet the definition of a business in ASC 805. Chapter 2 in our FRD publication, Business combinations, provides interpretative guidance on applying the definition of a business in ASC 805.

An entity does not have to meet the definition of a business to be a joint venture. For example, a newly established entity could have inputs used for research and development activities (e.g., intellectual property, fixed assets), but no employees, processes or outputs, meaning it would not meet the definition of a business under ASC 805. We believe an entity that does not meet the definition of a business could still be a joint venture, as long as the inputs (e.g., assets) are held in a separate legal entity, there is joint control over the significant decisions of the entity and the venturers are able to exercise joint control through their equity investments.
2.3  

**Joint ventures must be under the joint control of the venturers**

Joint control is the characteristic that makes joint ventures unique from other entities. ASC 323-10-20 describes the basic elements of joint control by stating that “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.”

We believe joint control exists when all of the significant decisions related to an entity require the unanimous consent of all of the venturers (the only exception is when small noncontrolling interests are held by public ownership, as discussed in Section 2.3.6). Unanimous consent exists when any individual venturer can prevent any other venturer or group of venturers from making significant decisions without its consent (e.g., via substantive approval or veto rights). The venturers will have a more than passive participation in a joint venture when they have the ability to effectively participate in all of the significant decisions of the entity. For these reasons, a joint venture would not be consolidated by any of the equity holders (i.e., it would not be a subsidiary of a venturer).

<table>
<thead>
<tr>
<th>Illustration 2-5: Evaluating whether an entity with passive investors is a joint venture</th>
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<tbody>
<tr>
<td><strong>Facts</strong></td>
</tr>
<tr>
<td>Assume Companies A, B and C each contribute businesses into a new legal entity. The companies retain equity interests of 45%, 45%, and 10%, respectively. A and B appoint two members to a four-member board of directors. All significant decisions require the unanimous consent of the board members. A and B exercise control exclusively through rights granted via their equity interests. C cannot appoint a board member, and is a passive investor with no substantive rights to participate in any of the significant decisions of the entity. A, B, and C are not related parties.</td>
</tr>
</tbody>
</table>
| **Analysis**

Based on the facts provided, the entity is not a joint venture. Even though the activities are conducted through a separate legal entity and the venturers participating in decision making exercise control through their equity investments, significant decisions do not require the unanimous consent of all of the venturers. That is, C cannot appoint a board member and does not have the ability to prevent A and B from making significant decisions without its consent (e.g., via substantive approval or veto rights).

---

1 The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

We further believe that a joint venture must have a substantive mechanism that establishes joint control among the venturers (e.g., a contractual agreement). The mechanism should stipulate the rights of the venturers as well as the level at which significant decisions are made (e.g., the shareholder level or the board of directors level). Each venturer must have substantive rights that ensure they consent to each significant decision before it is executed. These could be rights requiring that each venturer approve significant decisions (i.e., approval rights) or rights allowing each venturer to veto significant decisions (i.e., veto rights). The mechanism must have substance, meaning its terms cover all significant decisions, cannot be superseded and do not include any restrictions on the ability of the venturers to exercise their rights.
Question 2.1  Could an entity be a joint venture if no substantive mechanism to ensure joint control exists (e.g., there is no contractual agreement)?

Generally, no. However, in certain circumstances, joint control could exist in the absence of a contractual agreement, such as when two venturers have equal voting equity interests in an entity (i.e., 50/50 ownership) and no other arrangements would override the voting rights. In this scenario, each venturer would need the consent of the other to make significant decisions related to the entity. We believe instances in which joint control exists in the absence of a contractual agreement are rare. When no contractual agreement exists, it is important to closely evaluate how joint control is ensured in the absence of an agreement.

2.3.1  Evaluating joint control

In determining whether joint control exists, we believe the Voting Model provides a helpful framework (see Section 2.1.1 for additional discussion on applying the Voting Model to joint ventures). The Voting Model framework presumes that the majority owner of the outstanding voting equity (for corporations or similar entities) or the general partner (for partnerships or similar entities) controls and therefore must consolidate an entity, unless certain conditions are present that overcome the presumption of control. One condition occurs when one or more of the minority shareholders or limited partners hold substantive veto or approval rights, allowing them to effectively participate in one or more of the significant decisions of the entity. Being able to “effectively participate” means having the ability to block significant decisions proposed by the majority owner or general partner. The likelihood that such a right will be exercised is not considered in the evaluation. We believe joint control exists when all of the venturers have, at a minimum, substantive veto or approval rights allowing them to effectively participate in all of the significant decisions of an entity. (For this reason, a joint venture would not be a consolidated subsidiary of any of the equity holders).

Under the Voting Model’s framework, decisions are significant when they relate to the significant financing, operating and investing activities expected to be undertaken by an entity in the normal course of business, regardless of whether the events or transactions that would necessitate such decisions are expected to occur in the near term. To be significant, however, it must be at least reasonably possible that the events or transactions will occur. To be jointly controlled, we believe each significant decision of the entity must require the consent of each of the venturers. The venturers, therefore, at a minimum, must be able to effectively participate in those significant decisions through substantive veto or approval rights. To be substantive, these rights must have no significant barriers to exercise (i.e., significant penalties or other hurdles making it difficult or unlikely they could be exercised).

In applying the Voting Model’s framework, it is important to understand the level at which significant decisions are made. For example, in a corporation or similar entity, significant decisions might be made by a direct vote of the shareholders, by a vote of the board of directors or by both methods. Alternatively, in a partnership or similar entity, significant decisions might be made by the general partner or some or all significant decisions might be put to a vote by the limited partnership as a whole. In any scenario, each venturer must have substantive rights allowing them to effectively participate in the significant decisions at the level at which those significant decisions are made. Also, no venturer should have tie-breaking authority (See Section 2.3.4 for a discussion of tie-breaking authority).

It is important to note that when there are more than two venturers in an entity, we do not believe an arrangement in which significant decisions are made by a simple majority vote (i.e., majority rule decision-making in which there is no mechanism to ensure unanimous consent) would meet the definition of joint control. All venturers must unanimously consent to significant decisions for the entity to be jointly controlled.
The ASC Master Glossary (the Glossary) includes a definition of joint control that could be interpreted as allowing for majority-rule decision-making. The definition states that joint control exists “if decisions regarding the financing, development, sale, or operations require the approval of two or more of the owners.” Nonetheless, we do not believe the definition of joint control in the Glossary applies when identifying joint ventures, as it is used only once, in the real estate industry guidance in ASC 970-323, in the narrow context of distinguishing when to apply equity method accounting or proportionate consolidation to real property owned by undivided interests. The term is not used in the context of identifying joint ventures and therefore we do not believe it applies to this evaluation.

<table>
<thead>
<tr>
<th>Illustration 2-6: Evaluating whether an entity with “majority rule” is a joint venture</th>
</tr>
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<tbody>
<tr>
<td><strong>Facts</strong></td>
</tr>
<tr>
<td>Assume Companies A, B and C each contribute businesses into a new legal entity. Each of the companies retains a 33 1/3% equity interest and appoints one member to a three-member board of directors. All significant decisions require approval by a majority of the board members (i.e., the majority makes the significant decisions and each of the individual companies lacks the ability to unilaterally veto those decisions). The companies exercise control exclusively through rights granted via their equity interests. The companies are not related parties.</td>
</tr>
<tr>
<td><strong>Analysis</strong>¹</td>
</tr>
<tr>
<td>Based on the facts provided, the entity is not a joint venture. Even though the activities are conducted through a separate legal entity and the venturers exercise control through their equity investments, significant decisions do not require the unanimous consent of the venturers. The majority-rule decision-making requirement does not meet the definition of joint control.</td>
</tr>
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</table>

¹ The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

**Question 2.2**

If the articles of incorporation state that decisions are made by a majority vote of the shareholders or board of directors, rather than by a unanimous vote, does this *automatically* mean the entity is not jointly controlled?

No. Joint control may still exist if, for example, each of the venturers has the ability to block, as needed, each of the significant decisions of the entity (i.e., each venturer has substantive veto or approval rights related to each significant decision). Alternatively, joint control may exist if the majority vote is defined so that it implicitly requires the unanimous consent of the parties (e.g., all significant decisions of a 50/50 joint venture require a majority vote). Terms of this nature should be evaluated carefully in the context of the entire arrangement to verify whether joint control exists.

Under the Voting Model’s framework, the following decisions are always considered significant:

- Selecting, terminating and setting the compensation of management responsible for implementing the investee’s policies and procedures
- Establishing operating and capital decisions of the investee, including budgets, in the ordinary course of business

Each venturer must be able to effectively participate in these decisions for the entity to be jointly controlled. Other significant decisions made by the entity should also be identified to determine whether the venturers can effectively participate in them.
Question 2.3

Are the significant decisions of a joint venture determined in the same manner as the most significant decisions of a variable interest entity under the Variable Interest Model (i.e., are they exclusively the decisions that most significantly affect the economic performance of an entity)?

No. The decisions that are evaluated under the Variable Interest Model as part of the process of determining the primary beneficiary are the decisions that most significantly impact the entity’s economic performance, which is a subset of all significant decisions. However, we believe the evaluation of joint control is similar to the evaluation of control under the Voting Model. That is, we believe the venturers will have joint control over all of the significant decisions of a joint venture, not just the “most significant decisions” as defined by the Variable Interest Model.

In many cases, the two models may result in identifying the same significant activities. In some cases, however, the Voting Model could result in identifying more activities. For example, ASC 810-10-25-11 indicates that significant decisions under the Voting Model are (1) selecting, terminating and setting the compensation of management, and (2) establishing operating and capital budgets. In contrast, under the Variable Interest Model, these would only represent significant decisions if they were among the activities that most significantly impacted the entity’s economic performance.

As another example, ASC 810-10-55 indicates that under the Voting Model, the decision to issue dividends may be a significant decision, if dividends are customary or expected (i.e., in the ordinary course of business). Conversely, under the Variable Interest Model, the issuance of dividends, even if customary or expected, frequently is not a decision that most significantly impacts an entity’s economic performance (although this conclusion would depend on the purpose and design of the entity).

See Section 2.1.1 for further discussion on applying the Variable Interest Model and the Voting Model to joint ventures.

2.3.2 Evaluating the effect of potential voting rights (e.g., call options, convertible instruments) on joint control

We generally believe the effect of potential voting rights should not be considered in determining whether an entity is under the joint control of the venturers. We do not believe instruments providing potential voting rights should be included in the evaluation until they are exercised. Once exercised, however, we believe a reassessment of whether joint control over the entity exists may be required. (See Section 2.5 for guidance on reassessing joint control).

In certain circumstances, the terms and conditions of an instrument providing potential voting rights may require further consideration of the substance of the arrangement (e.g., a fixed-price call option that is deep in the money with little economic outlay required to exercise), if the exercise of the right could affect the evaluation of joint control over the entity. This determination would depend on a careful evaluation of the specific facts and circumstances. Our FRD publication, Consolidation and the Variable Interest Model, provides further interpretive guidance on evaluating potential voting rights, which we believe applies in this context.

When the majority owner of a corporation or similar entity has a contractual right to buy out the interests of the minority owners for fair value or less, this also may affect whether the entity is a joint venture (see Section 2.3.7 for further discussion). The considerations in Section 2.3.7 also apply when the general partner of a partnership has a contractual right to buy out the interests of the limited partners for fair value or less.
Illustration 2-7: Evaluating the effect of potential voting rights (e.g., call options) on the determination of whether an entity is a joint venture

Facts
Assume Companies A and B each contributes a business into a new legal entity. Companies A and B are unrelated and each has a 50% equity interest and appoints two representatives to a four-member board of directors. All significant decisions require the unanimous consent of the board members. The companies exercise control exclusively through the rights granted via their equity interests. Company A has a call option, allowing it to buy 100% of the interest of Company B in two years at fair value.

Analysis
Based on the facts provided, the entity is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers and the venturers exercise joint control through their equity investments. We do not believe the terms of the call option should be considered until they are exercised by Company A.

1 The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

2.3.3 Evaluating the effect of related-party relationships on joint control

Evaluating joint control should incorporate a consideration of whether the venturers in an entity are related parties, as defined in ASC 850. While the presence of related parties does not automatically disqualify an entity from being a joint venture, there could be circumstances in which entities formed by related parties are not joint ventures. There are differences between the Variable Interest Model and Voting Model in the evaluation of related parties, and the effects of those differences on identifying a joint venture are highlighted below (see Section 2.1.1 for further discussion on applying the Variable Interest Model and the Voting Model to joint ventures).

For example, any entity designed (or redesigned) exclusively by related parties would be within the scope of the Variable Interest Model (i.e., even if the entity appeared to be a joint venture, it would not meet the business scope exception). In certain circumstances, the Variable Interest Model may require a member of the related-party group to consolidate the entity, even if power over the significant decisions of the entity is shared by the related parties. In this scenario, because one of the related parties would consolidate the entity, the entity could not be a joint venture, regardless of whether the characteristics of a joint venture may appear to be present (e.g., regardless of whether there is unanimous consent over significant decisions among the related parties). The definition of a joint venture in ASC 323 states clearly that a joint venture cannot be a subsidiary of one of the venturers. Our FRD publication, Consolidation and the Variable Interest Model, provides further interpretive guidance on applying the Variable Interest Model.

Other entities formed by related parties may still be joint ventures, as long as the entities have the characteristics of a joint venture described in this chapter. These entities would include entities formed exclusively by a related-party group that are not variable interest entities, majority-owned corporations, limited partnerships or similar entities (see Section 2.3.7 for further discussion). Other entities formed by a related-party group and one or more independent parties may also be joint ventures.

6 For entities being evaluated under the Variable Interest Model, this would also include de facto agents, as defined in ASC 810.
Illustration 2-8: Evaluating whether an entity formed by related parties is a joint venture

Example 1
Companies A and B are related parties and they form an entity to manufacture, distribute and sell widgets. Each party retains a 50% interest in the entity and appoints two members to a four-member board of directors. All significant decisions require the unanimous consent of the board members. Companies A and B exercise control exclusively through the rights granted via their equity interests.

Because the entity is formed exclusively by related parties, it is not eligible for the business scope exception to the Variable Interest Model. Upon applying the model, the entity is identified as a variable interest entity and Company A and B together are deemed to have both power and benefits. Under the related-party provisions of the Variable Interest Model, Company A is deemed to be most closely associated with the entity and therefore consolidates the entity.

Analysis
Based on the facts provided, because the entity is consolidated by, and thus a subsidiary of, one of the venturers, by definition the entity cannot be a joint venture. Our FRD publication, Consolidation and the Variable Interest Model, provides further interpretive guidance on applying the Variable Interest Model.

Example 2
Companies A and B are related parties and they join with Company C, an independent party, to form a business in a separate legal entity (Entity Z) to manufacture, distribute and sell widgets to third parties. Each party retains a 33 1/3% interest in Entity Z and appoints two members to a six-member board of directors. All significant decisions require the unanimous consent of the board members, which includes the consent of the two members appointed by Company C. Companies A, B and C exercise control exclusively through the rights granted via their equity interests.

Analysis
Based on the facts provided, the entity is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers and the venturers exercise joint control through their equity investments.

---

1 The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

2.3.4 Evaluating the effect of tie-breaking authority on joint control

Given the requirement for unanimous consent, it is critical to understand the mechanisms for remediating disputes among the venturers. Disputes include any circumstances in which the venturers disagree and cannot make a significant decision. The substantive mechanism ensuring joint control (e.g., the contractual arrangement) should include terms and conditions relating to the resolution of such disputes. If one party has authority by a right granted in the contract to break the tie (i.e., tie-breaking authority), joint control does not exist. However, joint control would not be compromised if the terms and conditions called for arbitration or for resolution via a separate, over-arching joint agreement among all of the venturers.
Illustration 2-9: Evaluating the effect of tie-breaking authority on joint control

Example 1

Facts
Assume Company A and Company B contribute businesses into a new legal entity. Companies A and B each retain a 50% interest in the entity and appoint three members to a six-member board of directors. All significant decisions require the unanimous consent of the board members. Companies A and B exercise control exclusively through rights held through their equity interests, but Company A has the power to appoint the CEO, and the CEO is the chairman of the board. As chairman, the CEO has the capacity to issue a tie-breaking vote, in the event of disagreement.

Analysis
Based on the facts provided, the entity is not a joint venture. Company A can exercise unilateral control through its appointment of the CEO, who has the tie-breaking vote in any dispute.

Example 2

Facts
Assume the same facts as in Example 1, with the following exception: In the event of a tie vote, a tie-breaking decision must be reached through the mutual agreement of the CEOs of Companies A and B. If no decision can be reached, the dispute goes to a third-party arbitration process.

Analysis
Based on the facts provided, the entity is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers and the venturers exercise joint control through their equity investments. Neither of the venturers controls the dispute resolution process and any disputes that cannot be resolved by the venturers are resolved by an independent arbiter.

1 The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

2.3.5 Evaluating the effect of a large number of venturers on joint control

US GAAP does not limit how many venturers can participate in a joint venture. Nonetheless, we generally would expect the number of venturers to be small because we believe obtaining unanimous consent over significant decisions from a large number of venturers would be difficult in practice. If an entity has more than a small number of venturers (the only exception is when small noncontrolling interests are held by public ownership – see Section 2.3.6), it would be important to carefully evaluate the means by which the venturers jointly control significant decisions.

2.3.6 Evaluating the effect of noncontrolling interests held by public ownership on joint control

The definition of a joint venture in ASC 323 states that passive noncontrolling interests held by public ownership do not preclude a corporation from being a joint venture. We believe ASC 323 provides this exception because it is unlikely the public investors would be able to actively participate in the decision-making with the venturers. Further, it would not be reasonable to require their unanimous consent in the joint control of the entity. In providing this exception, ASC 323 presumes the size of the interest would be small.
When an entity has a noncontrolling interest held by public ownership, it is important to understand how joint control over significant decisions is maintained by the venturers before concluding the entity is a joint venture. Among the questions to consider are:

- Do the primary venturers have rights allowing them to jointly control the significant decisions of the entity without the consent of the public noncontrolling interest holders?
- What rights, if any, do the public interest holders have?
- What is the size of the public noncontrolling interest relative to the interests of the parties with joint control? A large interest held publicly may require the interest holders to have a greater ability to actively participate in the decision-making with the venturers.

ASC 323’s reference to noncontrolling interests in the definition of a joint venture mentions only interests held publicly. We do not believe analogies should be made to this exception when evaluating privately held voting interests.

Illustration 2-10: Evaluating whether an entity with publicly traded equity is a joint venture

Facts

Assume Companies A and B each contribute businesses into a new legal entity (Entity A) in exchange for an equity interest. In connection with its formation, Entity A also issues shares publicly, which are held by a diverse group of investors. Companies A and B are not related parties.

At Entity A’s formation, Companies A and B each have a 45% equity interest and the remaining 10% equity interest is held publicly. Companies A and B each appoint five members to a 10-member board of directors. The public shareholders do not appoint board members.

All significant decisions require a unanimous vote by the members of the board of directors. The companies exercise control exclusively through the rights granted via their equity interests.

Analysis

Based on the facts provided, Entity A is a joint venture. The activities are conducted in a separate legal entity, all significant decisions effectively require the unanimous consent of the venturers (Companies A and B) and the venturers exercise joint control through their equity investments (i.e., via their ability to appoint members to the board of directors). The public equity holders do not overcome the joint control of the entity by companies A and B. As a result of the wide disbursement of their shareholdings and their lack of voting rights, the public interests would be treated as passive interests, consistent with the definition of a corporate joint venture in ASC 323.

1 The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).
Additional considerations for evaluating whether a majority-owned entity or a limited partnership (or similar entity) can be jointly controlled

An entity in which one of the venturers owns a majority of the equity interests may be a joint venture when the significant decisions of the entity require the unanimous consent of the other venturer(s) and the remaining characteristics of a joint venture are present. It is important to highlight that joint ventures with a majority equity owner may fail one of the criteria needed to qualify for the business scope exception to the Variable Interest Model, because the majority owner is providing more than half of the subordinated financial support (i.e., equity) to the entity. See Section 2.1.1 for further discussion on applying the Variable Interest Model and the Voting Model to joint ventures.

Under the Voting Model, several additional factors may need to be considered when evaluating whether a majority-owned corporation or a limited partnership (or similar entity) is jointly controlled, pursuant to the requirements for those entities contained in ASC 810-10-25-13 and ASC 810-20-25-20, respectively.

For example, as the disparity between the ownership interest of majority and minority owners of a corporation increases, minority owners’ rights (e.g., veto or approval rights) are presumptively more likely to be protective and should raise the level of skepticism about the substance of those rights. That is, if the majority owner owns 90% of the outstanding equity, it may be less likely the 10% owner can effectively participate in each of the significant decisions of the entity.

Furthermore, if a majority-owned corporation or limited partnership (or similar entity) is formed exclusively by related parties, it generally cannot be a joint venture. Under the Variable Interest Model, a majority-owned corporation (or similar entity) formed by related parties in which the majority owner does not have voting rights proportionate to its ownership interest generally would be identified as a variable interest entity (based on the related party considerations in the anti-abuse clause), and a member of the related party group would be required to consolidate the entity (see also Sections 2.1.1 and 2.3.3). For limited partnerships (or similar entities) formed by related parties, those related party relationships would need to be evaluated carefully when concluding on the substance of any rights held by the limited partner(s). For example, if a limited partner is a member of the immediate family of the general partner, the rights of the limited partner(s) (e.g., veto or approval rights) likely would not be considered substantive and generally would not overcome the presumption of control by the general partner.

Additionally, when the majority owner of a corporation or the general partner of a limited partnership (or similar entity) has a contractual right to buy out the interests of the minority owner(s) or limited partner(s) for fair value or less, the entity also may not qualify to be a joint venture. The feasibility of exercising that contractual right should be considered when evaluating the substance of the rights of the minority owners or limited partners (e.g., veto or approval rights) to effectively participate in the significant decisions. If the buyout is prudent, feasible and substantially within the control of the majority owner or general partner, the minority owners’ or limited partners’ rights would not be substantive. The call option would negate the rights of the minority owners or limited partners to veto an action of the majority shareholder or general partner, although it would not create an additional ownership interest for the majority shareholder or general partner. However, it would not be prudent, feasible, and substantially within the control of the majority owner or general partner to buy out a minority owner or limited partner if, for example, the minority owner or limited partner controlled technology that is critical to the entity.
Illustration 2-11: Evaluating whether an entity with a majority owner is a joint venture

Example 1

Assume Companies A, B and C each contributes a business into a new legal entity, in exchange for equity interests of 70%, 15% and 15%, respectively. Company A appoints five members and Companies B and C each appoint one member to a seven-member board of directors. All significant decisions require a majority vote by the board. Both companies B and C have substantive veto rights allowing them to effectively participate in all of the significant decisions of the entity. The companies exercise control exclusively through the rights granted via their equity interests and the companies are not related parties. Company A does not have a contractual right to buy out the interests of the minority owners.

Analysis

Based on the facts provided, the entity is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers (via the substantive veto rights of companies B and C) and the venturers exercise joint control through their equity investments.

Example 2

Assume the same facts, except that companies A and B have substantive veto rights allowing them to effectively participate in some (but not all) of the significant decisions. Company A does not consolidate on the basis of these rights.

Analysis

Based on the facts provided, in this example, the entity is not a joint venture. Joint control requires the unanimous consent of all of the venturers over all significant decisions.

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The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

2.3.8 Evaluating joint control over sequential activities

Some arrangements involve significant activities that occur at different stages in a process, with each party contributing unique industry expertise to the different stages. Arrangements of this nature are generally established in one of two ways:

- Individual parties have rights to direct significant activities at different stages.
- The parties jointly direct all significant activities at each stage.

In the first scenario, we do not believe joint control exists because one venturer has unilateral control over the significant decisions at each stage in the life of the entity. In the second scenario, we do believe joint control exists because all of the significant activities of the entity are subject to joint control at each stage in the life of the entity.

Arrangements with sequential activities may be complex. When a reporting entity enters into such an arrangement, it is important to carefully evaluate the facts and circumstances to identify the significant decisions and verify how joint control over those decisions is maintained during the life of the entity.

In some circumstances, an entity may be jointly controlled during one stage in its life cycle and revert to control by one of the parties at another stage. A right to control an entity that depends on the completion of certain significant activities would be treated similarly to a potential voting right, as
described in Section 2.3.2. Nonetheless, in this scenario, the facts and circumstances would need to be evaluated carefully to verify whether joint control truly exists during the initial or other later stage(s) of the entity's life cycle.

### 2.3.9 Evaluating the role of a government in joint control

In certain circumstances, a local or a national government may retain an interest in an entity formed within its jurisdiction. As stated in ASC 323, a government can be a party to a joint venture. Therefore, the mere presence of a government as an equity holder in an entity does not disqualify the entity from being jointly controlled. Nonetheless, the arrangement should be evaluated carefully to determine whether joint control exists. Depending on the facts and circumstances, a government may be reluctant to forgo final decision-making authority over such an entity.

### 2.3.10 Evaluating other indirect evidence of joint control

In evaluating joint control, consideration should be given to certain qualitative indicators that may provide evidence of whether joint control exists. For example, if an investor cannot obtain the financial information necessary to account for its involvement under the equity method, we believe this may be a strong indicator that the investor does not have joint control over the entity.

### 2.4 Joint control exercised through equity investments

For an entity to meet the definition of a joint venture, all of the venturers must exercise joint control exclusively through rights granted via their equity interests. We believe this characteristic is consistent with the definition of a joint venture in ASC 323, which describes joint ventures as being managed by their owners. As previously stated, each venturer must have rights granting them the ability to effectively participate in all significant decisions. Therefore, these rights must exist at all levels of the entity at which significant decisions are made (e.g., the board of directors).

It is important to consider all sources of decision making in this analysis. Sources of decision making may be embedded at lower levels of the organization (e.g., executive management) or in certain agreements related to the entity. If a venturer exercises its decision-making authority through a means other than an equity interest (e.g., through a management services contract) or if an interest holder other than one of the venturers has voting or substantive veto rights (e.g., via a debt instrument), we do not believe the entity is a joint venture.

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**Question 2.4** If a venturer or a third-party performs the day-to-day management of the entity, does this automatically mean the entity is not a joint venture?

No. The existence of a contract or other agreement with one of the venturers or with a third-party (i.e., an operations manager) to perform the day-to-day management of the entity does not automatically prevent the entity from meeting the definition of a joint venture. Such agreements may occur when a venturer or a third-party contributes direct industry experience to the entity that other venturers do not have. As long as the contract does not convey decision-making authority over significant decisions to the venturer or the third-party, the entity could meet the definition of a joint venture, provided the other required characteristics of a joint venture are present.

Nonetheless, when decision-making over certain activities rests with the board of directors while decision-making over other activities rests with an operations manager, it may be challenging to assess whether the board (appointed by the venturers) or the operations manager has control over the significant decisions of the entity. The evaluation of whether joint control exists in these circumstances requires significant judgment based on the facts and circumstances. Our FRD publication, *Consolidation and the Variable*
**Interest Model**, provides further interpretive guidance and an illustrative example on evaluating whether a management service contract conveys control over the significant decisions of an entity to an operations manager. We believe that guidance likewise applies to evaluating joint ventures under either the Variable Interest Model or the Voting Model.

### 2.4.1 Evaluating the effect of the joint sharing in risks and rewards on joint control

ASC 323 states that joint ventures are operated “for the mutual benefit” of the venturers and that the venturers frequently share the “risks and rewards” of the entity. We believe the venturers, as a group, will share jointly in the losses and expected returns of a joint venture through their equity interests, with each individual venturer participating in at least the upside (i.e., the expected returns) or the downside (i.e., the expected losses) risks.

We believe that terms significantly limiting one or more of the venturer’s participation in both the upside and downside of the entity would indicate that their equity interest does not have substance and may indicate that the venturer is acting as a fiduciary (i.e., an agent). We believe this would preclude the entity from being a joint venture, since one or more interest holders would be participating in significant decisions via an interest that did not have the characteristics of an equity interest.

We do not believe venturers will always share evenly in the risks and rewards of a joint venture. The economic interests of the venturers may therefore be disproportionate with their voting interests in some circumstances.

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<tr>
<th>Illustration 2-12: Evaluating the effect of disproportionate sharing in risks and rewards on joint control</th>
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**Facts**

Assume Companies A, B, and C each contribute businesses into a new legal entity (Entity X). Companies A and B each have a 40% equity interest and Company C has a 20% equity interest. Each company appoints one representative to a three-member board of directors. All significant decisions related to Entity X require the unanimous consent of the members of the board of directors. The companies exercise control exclusively through the rights granted via their equity interests. Companies A, B and C are not related parties.

**Analysis**

Based on the facts provided, Entity X is a joint venture. The activities are conducted in a separate legal entity, all significant decisions require the unanimous consent of the venturers and the venturers exercise joint control through their equity investments. The disproportionate economic interests of Companies A, B, and C do not factor into the analysis.

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1. The evaluation of whether an entity is a joint venture requires a consideration of whether the entity should be consolidated by any of its venturers and therefore should always begin by considering the Variable Interest Model (see Section 2.1.1 for further discussion).

### 2.5 Continuous reassessment

Once it is determined that an entity meets the definition of a joint venture, it is important to continuously reassess the status of the entity each reporting period to verify that no significant events have occurred to change that status. An event is significant if it results in the entity losing any one of the three defining characteristics of a joint venture described in this chapter.
3 Accounting by the joint venture at formation

3.1 Accounting at formation

Excerpt from Accounting Standards Codification
Business Combinations – Overall
Scope and Scope Exceptions
805-10-15-4
The guidance in the Business Combinations Topic does not apply to any of the following:
a. The formation of a joint venture

US GAAP does not specifically address the accounting by a joint venture for noncash assets contributed at formation. The EITF considered this issue in EITF 98-4, but did not reach a consensus. ASC 805-10-15-4 excludes the formation of a joint venture from the scope of ASC 805’s guidance on business combinations, and there is no other relevant authoritative guidance.

In light of this, joint ventures subject to SEC reporting requirements have generally looked to the views of the SEC staff for guidance. Due to the lack of authoritative guidance, the SEC staff’s views have also influenced practice for private companies. The sections that follow describe views on joint venture accounting expressed by members of the SEC staff in various forums. It is important to note that while these views provide a general understanding of the SEC staff’s perspectives on these matters, they are not authoritative and are subject to change. The SEC staff evaluates each fact pattern based on its interpretation of how the Codification applies to the specific facts and circumstances. Recently, the SEC staff has acknowledged diversity in practice in the accounting for joint venture formation transactions, which the staff believes is due to the lack of guidance and the inherent subjectivity of this determination. As a result, the SEC staff has encouraged registrants to consult with OCA about their conclusions related to joint venture formation transactions. See Section 3.1.2, Recent views expressed by the SEC staff, for further guidance.

This chapter provides the latest views in practice on the accounting by a joint venture at formation and they are not authoritative. The views discussed in this chapter may continue to evolve over time. It is important for readers to monitor developments in this area closely.

3.1.1 Background: SEC staff’s historical views

Historically, there was an understanding in practice that the SEC staff favored carryover basis for a joint venture when recognizing noncash assets contributed at formation, except in limited circumstances. The excerpt from the 1993 SEC staff speech below and the discussion that follows provide background information regarding this understanding of the staff’s previous view. As discussed in Section 3.1.2, more

Remarks by Christopher F. Rogers, Professional Accounting Fellow, Office of Chief Accountant at the 2014 AICPA National Conference on Current SEC and PCAOB Developments, 8 December 2014.
recent remarks by the SEC staff have led to an understanding in practice that the staff’s views on this accounting may be evolving, in light of changes in the accounting guidance applied by the venturers in these transactions (See Chapter 4 for interpretive guidance related to the venturers’ accounting).

**SEC staff speech excerpt (non-authoritative)**

1993 AICPA National Conference on Current SEC Developments

Another aspect of accounting by the investor involves the propriety of gain recognition upon the contribution of assets to a joint venture. The staff’s position has been, and continues to be, that contributing assets to a joint venture is not the culmination of the earnings process—it is an exchange of a portion of operating assets for a 50% interest in a larger pool of operating assets. The staff has modified its position when cash is received for the contribution of assets and certain other conditions are met. This is similar to the guidance provided in SOP 78-9, *Accounting for Investments in Real Estate Ventures*. Sometimes, cash is paid to balance the fair market values of the contributed assets.

For example, Company A contributes a business with a book value of $30 and a fair value of $100. Company B contributes a business with a book value of $20 and a fair value of $70, plus cash of $30. The joint venture then pays the $30 to Company A. The staff would not object to recognition of up to 50% of the indicated gain by Company A, limited to the amount of cash received. (Thus the calculated $35 gain would be limited to $30).

This assumes that Company A has no obligation to refund the cash to the joint venture or to Company B. The staff has also allowed gain recognition to the extent that other near-cash, monetary assets or traded, marketable securities are part of the settlement.

As indicated in the excerpt above, the SEC staff historically favored venturers recognizing equity investments received at formation at the carrying amount of the assets contributed, regardless of whether those assets met the definition of a business, except in limited circumstances. In general, the staff did not view the receipt of equity by the venturers as a culmination of the earnings process relative to those assets. These exchanges of assets for equity effectively were viewed by the staff as exchanges of operating assets for interests in a larger pool of operating assets.

In limited circumstances, the SEC staff believed gain recognition might be appropriate, by analogy to the guidance in EITF 01-2 (codified in ASC 845). The staff believed that gain recognition might be appropriate when a venturer exchanged an ownership interest in an individual asset (or assets) or a business for (1) an ownership interest in a joint venture and (2) monetary consideration. However, the staff believed the gain generally should be limited to the amount of the monetary consideration exchanged. A venturer would only recognize the portion attributable to the other venturer(s).

Even in these limited circumstances, the SEC staff believed the appropriateness of gain recognition depended on the facts and circumstances. If significant uncertainty existed regarding the culmination of the earnings process or there was an implied commitment to fund the activities of the joint venture, the staff believed gain recognition would not have been appropriate.

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8 Remarks by Jan R. Book, SEC staff member at the 1993 AICPA National Conference on Current SEC Developments, 12 January 1993
17. Practice gravitated toward historical cost as the basis for recording in the financial statements of the joint venture the assets contributed by each venture. Practice also appears to have been heavily influenced by the view that for a new basis of accounting to be appropriate in the stand-alone financial statements of a joint venture, the following characteristics must exist (a) there must be a contribution of assets or a business into a new entity; (b) the fair value of the assets or business must be objectively determinable and supported by an equal contribution of monetary assets by another investor; (c) the monetary assets must stay in the new entity or be used by the new entity in transactions with parties other than the venturers; and (d) there must be an equal allocation of equity and profits and losses among the venturers.

In practice, there also was historically a belief that the SEC staff similarly favored joint ventures recognizing contributed assets on a carryover basis. It was understood that the SEC staff generally believed that contributed assets should be recorded by the joint venture at the venturer’s carrying amount immediately prior to the transaction, which may have been based on concerns about whether there was an objective way for the joint venture to measure the fair value of the contributed assets. These views generally analogized to the conclusions in SAB Topic 5-G (codified in ASC 845-10-S99-1), which states that “transfers of nonmonetary assets to a company by its promoters or shareholders in exchange for stock prior to or at the time of the company’s initial public offering normally should be recorded at the transferor’s historical cost basis determined under generally accepted accounting principles.” This guidance provided an exception in “situations where the fair value of either the stock issued or the shares acquired is objectively measurable and the transferor’s stock ownership following the transaction was not so significant that the transferor had retained a substantial indirect interest in the assets as a result of stock ownership in the company.”

In practice, there was a belief that the SEC staff would accept (although not require) an adjustment of the contributed assets to fair value only when all of the following criteria were met: 7

• The assets were contributed to a newly formed entity.
• The newly formed entity met the definition of a joint venture.
• Fair value was objectively determinable by the contribution of at least an equal amount of monetary assets by the other venturers.
• The monetary assets stayed within the joint venture.
• There was a proportionate allocation of equity and profit and loss.
• No investor unilaterally controlled the joint venture.

These criteria were restrictive and often resulted in joint ventures applying carryover basis to contributed assets.

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9 This understanding, cited in Issue Summary No. 1 to EITF Issue 98-4, is consistent with statements made by members of the SEC staff in response to specific joint venture fact patterns, as described in the publicly available minutes of meetings of certain AICPA committees in November 1988, June 1989, September 1991 and December 1991.
3.1.2 Recent views expressed by the SEC staff

SEC staff speech excerpt (non-authoritative)

2009 AICPA National Conference on Current SEC and PCAOB Developments

I’d like to now discuss some interesting questions that have come up concerning the accounting for joint venture formation transactions. However, before we get into the accounting for the joint venture itself, let’s spend a minute discussing some of the recent changes to the investor accounting that seems to be driving some of the interest in this topic.

First, from the joint venture investor’s perspective, prior to the adoption of Statement 160, the transfer of a consolidated business in exchange for an interest in a joint venture would not result in gain recognition, absent the receipt of cash or near cash consideration and after careful evaluation of the specific facts and circumstances. After the effective date of Statement 160, which we understand that the FASB has an active project on their agenda to clarify through an Accounting Standards Update, a joint venture investor will recognize a gain or loss upon de-recognition of the consolidated business based on the difference between the fair value of consideration received and the carrying amount of the net assets contributed.

Now, as it relates to the accounting for the joint venture itself, Statement 141(R) excludes from its scope the accounting for the formation of a joint venture. The staff has historically conveyed strong views when considering the use of fair value in recording noncash assets contributed to a joint venture. More specifically, many believe that the staff would only support step-up to fair value when certain conditions are met, including where the asset or business is contributed to a new entity and fair value is supported by an equal amount of monetary assets that either remains in the entity or is used by the new entity in transactions with parties other than investors in the venture.

There may be questions developing on the topic of new basis for joint venture formation transactions as a result of these recent changes. The good news or, depending on your perspective, the bad news is that I’m not going to roll out a new model for new basis in joint venture formation transactions. There are certainly a number of good questions surrounding new basis accounting in general. In the absence of additional standard setting, there may be more circumstances where it may be appropriate to record the contributed business at fair value. This is an area that requires a significant amount of analysis and you should carefully evaluate the facts and circumstances surrounding the transaction and determine whether you believe new basis of accounting will result in decision-useful information to investors.

We believe the SEC staff’s views on the accounting joint ventures apply at formation may be evolving because of the changes to the accounting applied by venturers made by Statement 160 in 2007 and ASU 2010-02. Venturers now initially recognize their equity investments in joint ventures at fair value when they contribute businesses, with certain exceptions (See Chapter 4, which discusses the accounting applied by the venturers). As indicated in the speech above, the SEC staff now may believe there are more circumstances in which it may be appropriate for joint ventures to measure contributed businesses at fair value.

As the accounting by venturers changed and the use of fair value has grown, we believe practice is changing to a view that registrants may no longer have to meet strict guidelines for a joint venture to use fair value. We believe one reason for the staff’s willingness to accept fair value in more circumstances may be based on an interest in achieving more symmetry by minimizing basis differences between the venturers and the joint venture, while also providing decision-useful information to investors.

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10 Remarks by Joshua S. Forgione, SEC staff member at the 2009 AICPA National Conference on Current SEC and PCAOB Developments, 7 December 2009
The SEC staff’s 2009 speech focused on contributions of assets that meet the definition of a business in ASC 805. Therefore, we believe the first step in determining how a joint venture should account for contributed assets is evaluating whether those assets meet the definition of a business. Section 3.1.3 discusses the accounting for assets that meet the definition of a business. Section 3.1.4 discusses the accounting when the contributed assets and the joint venture upon formation do not meet the definition of a business.

SEC staff speech excerpt (non-authoritative)

2014 AICPA National Conference on Current SEC and PCAOB Developments

...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 that should be accounted for as a business combination under Topic 805 requires a significant amount of judgment. Given the inherent subjectivity in making this distinction, coupled with the lack of guidance in U.S. GAAP on the accounting by a joint venture, significant diversity in practice exists in accounting for these transactions. This diversity has created a lack of comparability between what are otherwise substantively similar transactions. As Jim Schnurr mentioned in his remarks earlier this morning, comparability is a hallmark of U.S. financial reporting. As a result, the staff believes it would be appropriate for the FASB to consider providing clarity on the definition of a joint venture in Topic 323, and to provide guidance on the appropriate accounting in the stand-alone financial statements of a joint venture for assets and businesses contributed to the joint venture. In the meantime, as always, we encourage registrants and auditors to come in and talk to us as they consider the appropriate accounting for joint venture formation transactions.

Because of the diversity in practice in the accounting for joint venture formation transactions, as described above, the SEC staff has encouraged registrants to consult with OCA about their conclusions related to joint venture formation transactions.

3.1.3 Accounting for assets that meet the definition of a business

Excerpt from Accounting Standards Codification

Business Combinations – Overall

Glossary

805-10-20

Business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

11 Remarks by Christopher F. Rogers, Professional Accounting Fellow, Office of Chief Accountant at the 2014 AICPA National Conference on Current SEC and PCAOB Developments, 8 December 2014.
If the assets contributed at formation meet the definition of a business, there are two general approaches a joint venture might consider when recognizing those assets: (1) a fair value approach (see Section 3.1.3.1) or (2) a carryover basis approach (see Section 3.1.3.2). Chapter 2 in our FRD publication, *Business combinations*, provides interpretative guidance on applying the definition of a business.

As stated in Section 3.1.2, this is an area that requires a significant amount of judgment and a careful evaluation of the facts and circumstances. When selecting an approach, consideration should be given to the views of the SEC staff (see Section 3.1.1 and Section 3.1.2), including evaluating whether the approach selected would result in decision-useful information for financial statement users.

### 3.1.3.1 Fair value approach: overview

The fair value approach may be appropriate for recognizing assets that meet the definition of a business when all of the following conditions are met:

- The new entity meets the definition of a joint venture in ASC 323.
- The venturers are not related parties.
- Fair value is reasonably determinable.

We believe instances in which fair value would not be reasonably determinable would be rare, given the increasing prevalence of fair value measurements in financial reporting and recent developments in the related accounting guidance (i.e., ASC 820).

We believe a fair value approach generally should follow the flow of the formation transaction, in which consideration (e.g., equity) is “transferred” in exchange for a business. Therefore, by analogy to the model for business combinations in ASC 805, we believe a joint venture would recognize goodwill at formation as the difference between the value of the consideration transferred and the fair value of the net assets received. Even though ASC 805 specifically excludes joint venture formations from its scope, we believe the principles in ASC 805 provide a practical framework for establishing initial measurement, given that there is no other authoritative guidance for these transactions.

<table>
<thead>
<tr>
<th>Illustration 3-1: Fair value approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of consideration transferred</td>
</tr>
<tr>
<td>Fair value of identifiable net assets received</td>
</tr>
<tr>
<td>Goodwill</td>
</tr>
</tbody>
</table>

A fair value approach would begin with a determination of the value of the consideration transferred. We believe there are three acceptable views on how to make this estimate, as summarized in Illustration 3-2 below. Each view applies the fair value measurement principles in ASC 820. The views generally differ in their treatment of synergies and control or acquisition premiums. Therefore, they may result in different amounts of goodwill and basis differences between the joint venture and its venturers. (Section 3.1.3.1.4 discusses these differences further).

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12 See Section 4.6.2 of our FRD publication, *Business combinations*, for a discussion of both acquisition premiums and control premiums.
13 The FASB has issued a proposal to simplify the equity method of accounting by eliminating the requirement that an investor account for basis differences after initial recognition of the equity method investment.
Illustration 3-2:  Summary of views on measuring the fair value of consideration transferred

<table>
<thead>
<tr>
<th>View</th>
<th>Summary of view</th>
<th>Could result in a basis difference between joint venture and venturers?</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Push down&quot; view</td>
<td>The value of the consideration transferred equals the aggregate fair value amounts initially recognized by the venturers for their equity investments.</td>
<td>No</td>
<td>3.1.3.1.1</td>
</tr>
<tr>
<td>Standalone entity view</td>
<td>The value of the consideration transferred equals the fair value of the joint venture immediately after formation.</td>
<td>Yes</td>
<td>3.1.3.1.2</td>
</tr>
<tr>
<td>Multiple business combination view</td>
<td>The value of the consideration transferred equals the aggregate fair value of the individual businesses contributed.</td>
<td>Yes</td>
<td>3.1.3.1.3</td>
</tr>
</tbody>
</table>

The next step in a fair value approach would be measuring the fair value of the identifiable assets and liabilities contributed to the newly formed venture, including any identifiable intangible assets. These measurements would follow the principles in ASC 820 and would not be affected by the view selected for measuring the value of the consideration transferred. Once these measurements are determined, the joint venture would then recognize goodwill (if any), which is calculated as the difference between the value of the consideration transferred and the fair value of the net assets received.

Our understanding is that any of the three views provided in Illustration 3-2 are accepted in practice. Nonetheless, these views should not be viewed as authoritative. They reflect current perspectives and could change over time as a result of changes in accounting guidance or changes in the views of the SEC staff. Our FRD publication, *Fair value measurement*, provides general interpretive guidance on applying the fair value measurement principles in ASC 820. We believe companies should consider using valuation professionals to help them perform these fair value measurements.

3.1.3.1.1  “Push down” view of estimating consideration transferred

Under the “push down” view, a joint venture determines the value of the consideration transferred by aggregating the amounts initially recognized by the venturers for their equity investments (see Chapter 4, which discusses the accounting applied by the venturers for their equity investments). Although there is no preferred view, the “push down” view is generally considered the most practical because it will not result in a basis difference at formation between the venturers and the joint venture.

Under this view, fair value used to record the assets and liabilities (including goodwill) of the joint venture is based on the sum of the amounts recorded by venturers for their investment in the joint venture. In measuring the fair value of their investments, the venturers would generally measure the value of the newly formed joint venture entity and apply their percentage equity ownership to that value. The measurement of the joint venture (and therefore the venturers’ equity interests) would take into consideration all synergies that the joint venture is expected to realize after formation, but would exclude any potential control premiums, since no individual venturer would control the joint venture.

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14 This view is referred to as the “push down” view because the measurement basis of the venturers is being pushed down and used in the separate financial statements of the joint venture. The term “push down” is intentionally in quotes, however, as this is not true pushdown accounting. ASC 805-50, *Business Combinations - Related Issues*, allows pushdown accounting for any acquired entity, over which control was obtained. Appendix B in our FRD, *Business combinations*, provides further interpretive guidance related to push down accounting.
In summary, under the “push down” view, the value of the consideration transferred is determined based on the aggregate price that would be received through the sale, in separate transactions, of the ventures’ individual equity interests. Consideration of an acquisition premium may be appropriate if market participants would consider such a premium in pricing the individual noncontrolling equity interests. (See Section 3.1.3.1.4, which summarizes these fair value assumptions and compares them with the remaining two views).

Illustration 3-3 provides an example of the push down view.

<table>
<thead>
<tr>
<th>Amounts recognized by Companies A and B at formation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity investment in Joint Venture C recognized by Company A</td>
</tr>
<tr>
<td>Equity investment in Joint Venture C recognized by Company B</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amounts recognized by Joint Venture C at formation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of net identifiable assets</td>
</tr>
<tr>
<td>Goodwill</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Aggregate basis difference between the venturers and the joint venture:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

The goodwill calculated in these examples is for illustrative purposes only and is intended to highlight that each view may result in calculating a different amount of goodwill. However, these illustrative goodwill amounts should not be interpreted to imply that one view would always result in more or less goodwill than another. Actual differences in goodwill when applying these views would vary, depending on the facts and circumstances. See Section 3.1.3.1.4 for a discussion of these differences.
3.1.3.2 Standalone entity view of estimating consideration transferred

Under the standalone entity view, the joint venture at formation is valued as a single business. The estimated consideration transferred under this view is determined by considering what a market participant would pay to acquire 100% of the equity of the standalone entity in a transaction immediately after formation. Applying this view may result in a basis difference\(^\text{16}\) between the venturers and the joint venture if a market participant would pay a control or acquisition premium to acquire a controlling financial interest in the joint venture.

Under this view, the fair value measurement would include all expected synergies between the joint venture entity and market participants, including any synergies among the businesses contributed. As noted above, the measurement would also include a control or acquisition premium, if any, since the view assumes a market participant is obtaining a controlling financial interest in the entity (See Section 3.1.3.1.4, which summarizes these fair value assumptions and compares them with the “push down” view).

In summary, under the standalone entity view, the value of the consideration transferred is determined based on the fair value exit price for the joint venture entity immediately after formation.

Illustration 3-4 provides an example of this view.

<table>
<thead>
<tr>
<th>Illustration 3-4: Standalone entity view</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Illustration 3-3, the contributed assets form a single enterprise (i.e., Joint Venture C, which is the standalone entity) that manufactures and distributes automotive parts. Under the standalone entity view, the value of the consideration transferred reflects the price a market participant would pay to own 100% of the equity of Joint Venture C immediately after formation. Applying the principles in ASC 820, if a market participant would value the standalone entity at 230 immediately after formation, this would be the value of the consideration transferred under this view.</td>
</tr>
<tr>
<td>After measuring the consideration transferred, Joint Venture C would then separately measure the fair values of the identifiable assets and liabilities received, including any identifiable intangible assets. These measurements would not be affected by the application of the standalone entity view and therefore are assumed to be 180, consistent with Illustration 3-3.</td>
</tr>
<tr>
<td>The goodwill recognized (50)(^\text{15}) by Joint Venture C under this view would be the difference between the consideration transferred (230) and the fair value of the net assets (180). Assuming the same values as Illustration 3-3 for the venturer’s equity investments, there would be a total basis difference of 30 between the amounts recognized by the joint venture and the amounts recognized by Companies A and B at formation, as summarized in the table below.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amounts recognized by Companies A and B at formation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity investment in Joint Venture C recognized by Company A</td>
</tr>
<tr>
<td>Equity investment in Joint Venture C recognized by Company B</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amounts recognized by Joint Venture C at formation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of net identifiable assets</td>
</tr>
<tr>
<td>Goodwill</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Aggregate basis difference between the venturers and the joint venture:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total:</strong> 30(^\text{17})</td>
</tr>
</tbody>
</table>

---

\(^\text{16}\) The FASB has issued a proposal to simplify the equity method of accounting by eliminating the requirement that an investor account for basis differences after initial recognition of the equity method investment.

\(^\text{17}\) In this example, the basis difference represents the control or acquisition premium that was considered when valuing a 100% equity interest in the joint venture. In contrast, under the “push down” view in Illustration 3-3, a control or acquisition premium would not be considered when valuing each of the 50% interests of the venturers separately. See Section 3.1.3.1.4.
Multiple business combination view of estimating consideration transferred

Under the multiple business combination view, the joint venture would determine the value of the consideration transferred by considering what a market participant would pay to acquire each contributed business in a separate, distinct transaction. Similar to the standalone entity view, this view could result in a basis difference\(^\text{18}\) between the venturers and the joint venture.

Under this view, the measurement would include any market participant synergies associated with the individual businesses, but would not include any synergies that the joint venture would expect to realize from combining each of the respective businesses contributed by the venturers. The measurement would also generally include control or acquisition premiums, if any, associated with each of the individual businesses contributed, since the view assumes 100% of each business would be sold. (See Section 3.1.3.1.4, which summarizes these assumptions and compares them with the “push down” view).

In summary, under the multiple business combination view, the value of the consideration transferred is determined based on the aggregate price that would be received through the sale, in separate transactions, of the individual businesses contributed to form the joint venture.

Illustration 3-5 provides an example of this view.

Illustration 3-5: Multiple business combination view

In Illustration 3-3, the contributed businesses include a business that manufactures automotive parts and a business that distributes automotive parts. Under the multiple business combination view, the value of the consideration transferred would be the aggregate price that market participants would pay to separately acquire each of these businesses. Therefore, if a market participant would pay 110 for the manufacturing business and 110 for the distribution business in separate, unrelated transactions, the value of the consideration transferred would be 220 (i.e., 110 + 110).

After measuring the value of the consideration transferred, Joint Venture C would then separately measure the fair values of the identifiable assets and liabilities contributed, including any identifiable intangible assets. These measurements would not be affected by the application of the multiple business combination view and therefore are assumed to be 180, consistent with Illustration 3-3.

The goodwill recognized (40)\(^\text{15}\) by Joint Venture C under this view would be the difference between the consideration transferred (220) and the fair value of the net assets (180). Assuming the same values as in Illustration 3-3 for the venturer’s equity investments, there would be a total basis difference of 20 between the amounts recognized by the joint venture and the amounts recognized by Companies A and B at formation, as summarized in the table below.

<table>
<thead>
<tr>
<th>Amounts recognized by Companies A and B at formation:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity investment in Joint Venture C recognized by Company A</td>
<td>100</td>
</tr>
<tr>
<td>Equity investment in Joint Venture C recognized by Company B</td>
<td>100</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>200</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amounts recognized by Joint Venture C at formation:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of net identifiable assets</td>
</tr>
<tr>
<td>Goodwill</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Aggregate basis difference between the venturers and the joint venture:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total:</strong></td>
</tr>
</tbody>
</table>

---

\(^{18}\) The FASB has issued a proposal to simplify the equity method of accounting by eliminating the requirement that an investor account for basis differences after initial recognition of the equity method investment.

\(^{19}\) In this example, the basis difference represents the control or acquisition premium that was considered when valuing a 100% equity interest in each of the businesses separately contributed to form the joint venture, less the value of any unique synergies between these businesses. See Section 3.1.3.1.4.
3.1.3.1.4  

Comparison of the fair value measurement assumptions used in the three views

When applying a fair value approach, the measurement of the consideration transferred may include differing amounts related to synergies and control or acquisition premiums, depending on which view is applied. Illustration 3-6 summarizes these differences.

It is important to note that in fair value measurements, there may be some overlap between the value ascribed to a synergy and the value ascribed to a control or acquisition premium because control or acquisition premiums may be paid to achieve certain synergies. Therefore, it is important not to assume the value ascribed to a control or acquisition premium is always incremental to the value ascribed to a synergy.

![Illustration 3-6: Treatment of synergies and control/acquisition premiums in the three views](image)

(A) This view includes all market participant synergies. The approach would also include any synergies that the joint venture would expect to realize from combining each of the respective businesses contributed by the venturers.

(B) This view includes all market participant synergies, but excludes any synergies that the joint venture would expect to realize from combining each of the respective businesses contributed by the venturers. Those synergies are excluded, given that this view considers the price that would be received through the sale, in separate transactions, of the individual businesses.

(C) This view excludes a control premium. The venturers would not include control premiums in their fair value assumptions since the fair value of the joint venture in this view is based on the value of each individual venturer’s equity interest and no individual venturer controls the joint venture through its equity investment. Consideration of an acquisition premium may be appropriate if market participants would consider such a premium in pricing the individual noncontrolling equity interests.

(D) This view contemplates the sale of 100% of the equity in the joint venture immediately after formation and therefore would include a control or acquisition premium (if any).

(E) This view contemplates the sale of 100% of the equity in the individual businesses contributed to form the joint venture and therefore would include a separate control or acquisition premium (if any) for each business.

As demonstrated in Illustration 3-6, the three views generally treat synergies and control or acquisition premiums differently. Whether and by how much these differences would affect the measurement of the consideration transferred and, therefore, the amount of goodwill recognized depends on the facts and circumstances.

While there is no preferred view, the “push down” view may be the most practical because it minimizes basis differences between the venturers and the joint venture. Because the selection, application and evaluation of valuation techniques can be complex, entities should consider using valuation professionals to help them perform these fair value measurements.

3.1.3.2  

Carryover basis approach for assets meeting the definition of a business

A carryover basis approach would result in the joint venture recognizing the contributed businesses at the carrying amount of the contributing venturers, immediately before the transaction. There is no authoritative guidance precluding the use of a carryover basis approach. However, before deciding that the carryover basis approach is appropriate, careful consideration should be given to the published remarks of the SEC staff (see Section 3.1.2), which we believe indicate there may be more circumstances in which it may be appropriate to record the contributed business at fair value. When considering this approach, careful consideration should also be given to whether a carryover basis approach results in decision-useful information for the users of the financial statements. Given that the SEC staff has
acknowledged diversity in practice in the accounting for joint venture formation transactions, which the staff believes is due to the lack of guidance and the inherent subjectivity of this determination (See Section 3.1.2, Recent views expressed by the SEC staff), the SEC staff has encouraged registrants to consult with OCA about their conclusions related to joint venture formation transactions.\textsuperscript{20}

### 3.1.4 Accounting when the contributed assets and the joint venture upon formation do not meet the definition of a business

#### Excerpt from Accounting Standards Codification

<table>
<thead>
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<tr>
<td><strong>SAB Topic 5-G, Transfers of Nonmonetary Assets by Promoters or Shareholders</strong></td>
</tr>
<tr>
<td><strong>ASC 845-10-S99-1</strong></td>
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</tbody>
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The following is the text of SAB Topic 5-G, Transfers of Nonmonetary Assets by Promoters or Shareholders.

**Facts:** Nonmonetary assets are exchanged by promoters or shareholders for all or part of a company’s common stock just prior to or contemporaneously with a first-time public offering.

**Question:** Since FASB ASC paragraph 845-10-15-4 (Nonmonetary Transactions Topic) states that the guidance in this Topic is not applicable to transactions involving the acquisition of nonmonetary assets or services on issuance of the capital stock of an enterprise, what value should be ascribed to the acquired assets by the company?

**Interpretive Response:** The staff believes that transfers of nonmonetary assets to a company by its promoters or shareholders in exchange for stock prior to or at the time of the company’s initial public offering normally should be recorded at the transferors’ historical cost basis determined under GAAP.

The staff will not always require that predecessor cost be used to value nonmonetary assets received from an enterprise’s promoters or shareholders. However, deviations from this policy have been rare applying generally to situations where the fair value of either the stock issued\textsuperscript{1} or assets acquired is objectively measurable and the transferor’s stock ownership following the transaction was not so significant that the transferor had retained a substantial indirect interest in the assets as a result of stock ownership in the company.

\textsuperscript{1} Estimating the fair value of the common stock issued, however, is not appropriate when the stock is closely held and/or seldom or ever traded.

There is no guidance that directly addresses the accounting upon formation of a joint venture when neither the contributed assets nor the joint venture entity meet the definition of a business. The SEC staff speech we cite in 3.1.2 relates only to the accounting for assets that meet the definition of a business. The SEC staff has not provided publicly its views on the accounting for assets that do not meet the definition of a business.

\textsuperscript{20} Remarks by Christopher F. Rogers, Professional Accounting Fellow, Office of Chief Accountant at the 2014 AICPA National Conference on Current SEC and PCAOB Developments, 8 December 2014.
When determining the appropriate accounting in these circumstances, consideration may be given to the guidance in SAB Topic 5-G. We understand that the SEC staff has analogized to SAB Topic 5-G in similar transactions that involve newly formed legal entities recognizing contributed assets that do not meet the definition of a business. This guidance generally results in the new legal entity recognizing those assets at carryover basis. The guidance in SAB Topic 5-G partially stemmed from a concern over whether the fair value of certain contributed assets is objectively measurable.

In practice, consideration also is given to the accounting applied by the venturers to their equity investments, in an effort to minimize basis differences (See Section 4.1 for further interpretive guidance on the accounting applied by the venturers in these transactions). Following the accounting applied by the venturers may result in recognizing the contributed assets at an amount other than carryover basis.

Determining the approach to apply when recognizing contributed assets in these circumstances requires significant judgment. It involves a careful consideration of the facts and circumstances, including the needs of financial statement users.
4

Accounting by the venturers

4.1

Accounting at joint venture formation

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Except as provided in the following sentence, an investor shall measure an investment in the 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, 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.

The accounting venturers apply when initially recognizing the equity interests they receive at the formation of a joint venture generally depend on the nature of any assets they contribute. If the venturers contribute assets meeting the definition of a business or a nonprofit activity, the deconsolidation and derecognition guidance in ASC 810 requires the venturers to recognize the equity they receive at fair value, generally resulting in a gain or loss on the transaction. For additional interpretive guidance on ASC 810, see our FRD publication, Consolidated and other financial statements. The guidance in ASC 810 does not apply to sales of in-substance real estate or conveyances of oil and gas mineral rights, which are addressed in ASC 970-323 and ASC 932-360, respectively.

If the venturers contribute assets that do not meet the definition of a business, the venturers will need to consider whether the substance of the transaction is addressed by other guidance or whether the contribution is an interest in a subsidiary before applying ASC 810. (See Section 4.1.1 for further interpretive guidance on the accounting applied in these circumstances).

The decision tree in Illustration 4-1 summarizes the considerations a venturer would need to make when determining the appropriate accounting at formation.

Venturers also must consider the provisions of the Variable Interest Model when accounting for their equity interests in a joint venture. Our FRD publication, Consolidation and the Variable Interest Model, provides interpretive guidance related to the application of the Variable Interest Model.

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21 ASC 810-10-20 defines a nonprofit activity as “(a)n integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits, other than goods or services at a profit or profit equivalent, as a fulfillment of an entity’s purpose or mission (for example, goods or services to beneficiaries, customers, or members). As with a not-for-profit entity, a nonprofit activity possesses characteristics that distinguish it from a business or a for-profit business entity.”
4.1.1 Accounting for contributions of assets that do not meet the definition of a business

Excerpt from Accounting Standards Codification

Consolidation – Overall

Derecognition

Deconsolidation of a Subsidiary or Derecognition of a Group of Assets

810-10-40-3A

The deconsolidation and derecognition guidance in this Section applies to the following:

c. A subsidiary that is not a nonprofit activity or a business if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:

1. Topic 605 on revenue recognition
2. Topic 845 on exchanges of nonmonetary assets
3. Topic 860 on transferring and servicing financial assets
4. Topic 932 on conveyances of mineral rights and related transactions
5. Topic 360 or 976 on sales of in substance real estate.
Nonmonetary Transactions – Overall

Scope and Scope Exceptions

845-10-15-4

The guidance in the Nonmonetary Transactions Topic does not apply to the following transactions:

b. A transfer of nonmonetary assets solely between entities or persons under common control, such as between a parent and its subsidiaries or between two subsidiaries of the same parent, or between a corporate joint venture and its owners.

The deconsolidation and derecognition guidance in ASC 810 generally does not apply to the accounting by a venturer for contributions of assets that are not businesses or nonprofit activities. Therefore, if contributed assets do not meet the definition of a business, venturers must evaluate first whether the substance of the transaction is addressed directly by other guidance, including the following:

» Revenue recognition (ASC 605)22
» Transferring and servicing financial assets (ASC 860)
» Conveyances of mineral rights and related transactions (ASC 932)
» Sales of in substance real estate (ASC 360 and ASC 976)

The list above does not include ASC 845, since transactions between a joint venture and its owners are excluded from the scope of that guidance.

If the transaction is not addressed directly by other guidance, the applicable guidance would depend on whether the contribution is an interest in a subsidiary (i.e., a legal entity) that holds the assets, or the assets themselves. The deconsolidation and derecognition guidance in ASC 810 applies to a change in ownership that results in the loss of control of a subsidiary that is not a business or a nonprofit activity in circumstances when no other guidance directly addresses the substance of the transaction. Therefore, if a venturer contributes an interest in a subsidiary that holds the assets, the venturer would recognize any equity received at fair value and record a gain or loss on the transaction, pursuant to ASC 810.

Conversely, if no other guidance applies and the venturer contributes standalone assets (i.e., a group of assets that is not a business and that is not an interest in a subsidiary that holds the assets), we generally believe companies should analogize to ASC 845. Even though ASC 845’s scope excludes transfers of nonmonetary assets between a joint venture and its owners, we believe the principles in ASC 845 provide a practical framework for these transactions. When a venturer receives only equity in the exchange, we believe the exchange should generally be recorded at book value (i.e., a gain should not be recognized) because the economic substance of the transaction is a contribution to the capital of an entity and not a sale.

22 This publication has not been updated to reflect the issuance of ASU 2014-09 Revenue from Contracts with Customers, codified in ASC 606, or the resulting consequential amendments to ASC 810 and ASC 845.
### 4.2 Accounting subsequent to joint venture formation

Illustration 4-2 provides guidance on the possible alternatives a venturer could consider when accounting for its equity interest in a joint venture.

<table>
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<tr>
<th>Alternative</th>
<th>Guidance</th>
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<tr>
<td>Equity method</td>
<td>Investments in joint ventures are generally accounted for under the equity method, unless a venturer elects the fair value option or qualifies to apply proportionate consolidation (described below). Under the equity method, a venturer would perform a purchase price allocation pursuant to ASC 323 upon initially recognizing its equity interest. The allocation would allow the venturer to properly account for any differences between its bases in the underlying assets and liabilities of the investee and the bases recognized by the investee.</td>
</tr>
<tr>
<td>Fair value method</td>
<td>A venturer may elect to record its equity investment at fair value under ASC 825. The election is made on an instrument-by-instrument basis and is irrevocable, in accordance with ASC 825. If the fair value option is elected, all subsequent changes in fair value for the equity investment should be reported in earnings under ASC 825.</td>
</tr>
<tr>
<td>Proportionate consolidation</td>
<td>ASC 810-10-45-14 permits proportionate consolidation in limited circumstances for investments in unincorporated entities in the extractive and construction industries that would otherwise be accounted for under the equity method. A venturer would apply proportionate consolidation by reflecting its pro rata share of the joint venture’s assets, liabilities, revenues, and expenses in its financial statements. See ASC 810-10-45-14 for further guidance.</td>
</tr>
</tbody>
</table>

### 4.2.1 Income tax considerations

A taxable temporary difference may exist for the excess of the reported amount of an investment in a corporate or non-corporate joint venture over the related tax basis (outside-basis difference). A deferred tax liability is recognized for this outside basis difference unless an exception exists in ASC 740. For example, a deferred tax liability is not recognized for the excess outside book basis in a foreign corporate joint venture if the investor can appropriately assert that the earnings of the foreign corporate joint venture are indefinitely reinvested. Additionally, a deferred tax liability is required for an investment in a domestic corporate joint venture in all cases, except for the difference caused by undistributed earnings of a domestic corporate joint venture that arose in fiscal years beginning on or before 15 December 1992 if certain criteria are met.

ASC 740 restricts recognition of a deferred tax asset for the excess of the tax basis over the book basis of an investment in a corporate joint venture (domestic or foreign). For a deductible temporary difference, a deferred tax asset is recognized only if it is apparent that the difference will reverse in the foreseeable future.

For further discussion of outside-basis differences in domestic and foreign corporate joint ventures, see Chapter 14, *Foreign and domestic subsidiaries and US steamship entity temporary differences*, in our FRD publication, *Income taxes*.

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23 The FASB has issued a proposal to simplify the equity method of accounting by eliminating the requirement that an investor account for basis differences after initial recognition of the equity method investment.
4.2.2 Accounting at dissolution of a joint venture

In many cases, joint ventures are designed to have a limited life to achieve a certain strategic objective. In these circumstances, agreements may exist for determining a new basis of segregating the assets and liabilities among the owners or liquidating them and disbursing cash to the owners.

Generally, the venturer would need to determine whether the items received meet the definition of a business.

If the assets received meet the definition of a business, the venturer should account for the net assets obtained under ASC 805. The venturer would measure the fair value of the equity method investment at dissolution, which effectively becomes the consideration transferred. The venturer would then measure the fair value of the assets and liabilities received, including any identifiable intangible assets, and recognize goodwill. This treatment would result in a gain (or loss) upon dissolution, generally calculated as the difference between the fair value of the equity method investment and its carrying amount. See our FRD publication, *Business combinations*, for further guidance.

If the assets received do not meet the definition of a business, the transaction would be treated in accordance with ASC 845 or ASC 860, depending on the nature of the assets.
5

Disclosure requirements

5.1

Disclosures by the joint venture

We believe a joint venture should disclose the policies it elects with respect to accounting for assets contributed at formation, in addition to all other applicable disclosures required by US GAAP.

5.2

Disclosures by the venturers

Illustration 5-1 provides a summary of the significant disclosures a venturer should consider when reporting its interest in a joint venture.

<p>| Illustration 5-1: Summary of the disclosures |</p>
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<td>ASC 323-10-50</td>
<td>Equity method investments</td>
<td>Certain disclosures are required for investments accounted for under the equity method. This includes disclosures related to the election of the fair value option and related to any impairment charges that may be recorded on the equity method investment.</td>
<td>See our FRD publication, <em>Equity method investments</em>, for interpretive guidance.</td>
</tr>
<tr>
<td>ASC 810-10-50</td>
<td>Deconsolidation</td>
<td>Certain disclosure are required related to any gain (or loss) recognized on the deconsolidation of a subsidiary or derecognition of a group of assets. Certain additional disclosures are required for the fair value measurements relating to the retained investment upon deconsolidation.</td>
<td>See our FRD publication, <em>Consolidated and other financial statements</em>, for further interpretive guidance.</td>
</tr>
<tr>
<td>ASC 810-10-50</td>
<td>Variable interest entities</td>
<td>Certain disclosures are required, if the joint venture is determined to be a variable interest entity. (See Section 2.1.1 for further discussion on applying the Variable Interest Model to joint ventures).</td>
<td>See our FRD publication, <em>Consolidation and the Variable Interest Model</em>, for further interpretive guidance.</td>
</tr>
<tr>
<td>ASC 280-10-50</td>
<td>Segment reporting</td>
<td>Certain disclosures may be required, if the joint venture investment qualifies as a separate operating segment.</td>
<td>See our FRD publication, <em>Segment reporting</em>, for further interpretive guidance.</td>
</tr>
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5.3

SEC reporting considerations

Reporting considerations for SEC registrants with respect to equity method investments (including joint ventures accounted for by the equity method) are summarized in Section 7.5, *SEC reporting considerations*, of our FRD, *Equity method investments*. In addition, an SEC registrant may be required to file joint venture agreements under, S-K Rule 229.601(b)(10), *Material contracts*. 

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### Abbreviations used in this publication

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Corporate Joint Venture
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.

Business
An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs, or other economic benefits directly to investors or other owners, members, or participants. Additional guidance on what a business consists of is presented in paragraphs 805-10-55-4 through 55-9.

Consolidation
Any legal structure used to conduct activities or to hold assets. Some examples of such structures are corporations, partnerships, limited liability companies, grantor trusts, and other trusts.

In addition to the terms defined in the Codification, the following terms are included in this publication:

Venturers – Equity investors in a joint venture (excludes certain passive equity interests held by public ownership – see Section 2.3.6)

Joint control – Exists when all significant decisions require the unanimous consent of all of the venturers

Significant decisions – Those related to the significant activities of an entity

Significant activities – All significant financing, operating and investing activities expected to be undertaken by an entity in the normal course of business

Unanimous consent – Exists when any individual venturer can prevent any other venturer or group of venturers from making significant decisions related to the entity without its consent
D

Comparison of US GAAP to IFRS

D.1 Overview

IFRS (IFRS 11) provides guidance addressing joint arrangements, which are arrangements among two or more parties that have the following characteristics: (a) the parties are bound by a contractual arrangement and (b) the contractual arrangement gives two or more of those parties joint control of the arrangement.

Under IFRS 11, joint arrangements are classified and accounted for as either joint operations or joint ventures. In a joint operation, the parties with joint control have rights to the assets and obligations for the liabilities of the arrangement, and recognize their share of the arrangement’s assets, liabilities, revenues and expenses. In a joint venture, the parties with joint control only have rights to the net assets of the arrangement and therefore account for their interests under the equity method (proportionate consolidation is prohibited).

IFRS 11, which replaced IAS 31 and SIC-13, was effective for annual periods beginning on or after 1 January 2013.

Because US GAAP does not have a notion of a joint arrangement or of a subset of joint arrangements classified as joint operations, there may be differences in the accounting for these arrangements between US GAAP and IFRS. This appendix is not intended to address those differences.

US GAAP does have a notion of joint ventures, which is the focus of this appendix. IFRS 11 was partly designed to reduce existing differences between US GAAP and IFRS in the area of joint venture accounting. However, certain differences remain. These include differences in the characteristics used to determine whether an entity is a joint venture and certain differences in joint venture accounting.

D.2 Comparison of certain joint venture characteristics

Illustration D-1 compares and contrasts certain characteristics used to determine whether an entity is a joint venture in US GAAP and IFRS.

| Illustration D-1: Comparison of certain joint venture characteristics in US GAAP and IFRS |
|---------------------------------|------------------|------------------|
| Characteristic                          | US GAAP | IFRS |
| (A) The arrangement must be organized within a separate legal entity. | ✓ | ✓ |
| (B) The entity cannot be consolidated by any of the parties to the arrangement. | ✓ | ✓ |
| (C) The entity must be under the joint control of two or more parties. | ✓ | ✓ |
| (D) To be jointly controlled, the entity cannot have equity investors that do not participate in joint control (except for small passive interests held publicly). | ✓ | |
| (E) The parties with joint control must exercise joint control through their equity investments and cannot participate in joint control through rights granted via other interests (for example, via a management contract). | ✓ | |
| (F) The parties with joint control cannot have rights to the assets and/or obligations for the liabilities of the entity. | ✓ | |

1 IFRS 11 provides a condition that a joint venture must be structured through a “separate vehicle,” which may have a broader definition than a legal entity, as defined in US GAAP.

2 Under both US GAAP and IFRS, an investor must first determine whether it controls and therefore should consolidate the entity. Consolidation evaluations start with the Variable Interest Model in US GAAP (see Section 2.1.1) and IFRS 10 in IFRS.
In addition to the differences highlighted above, other differences exist. These stem primarily from differences in the consolidation guidance between US GAAP and IFRS, and include differences in how potential voting rights (e.g., call options, convertible instruments) and interests held by related parties are considered when evaluating whether an entity is controlled or jointly controlled.

Depending on the facts and circumstances, differences in the characteristics used to identify a joint venture in US GAAP and IFRS, including differences in how joint control is determined, could result in differences in the accounting an investor applies to its interest in an entity. For example, an investor could determine it controls and therefore should consolidate an entity under IFRS, even though the entity is a joint venture accounted for under the equity method in US GAAP (or vice versa).

In another example, an investor could determine an entity that is jointly controlled meets the definition of a joint operation instead of a joint venture under IFRS 11 (see characteristic (F) in Illustration D-1). The investor therefore would recognize its share of the entity’s assets, liabilities, revenues and expenses. In US GAAP, the investor may determine the same entity is a joint venture that should be accounted for under the equity method, which would be a significant difference. Alternatively, in limited circumstances, the investor could determine the entity qualifies for proportionate consolidation in US GAAP. However, certain differences between IFRS and US GAAP would still arise if the investor’s contractual rights and obligations with respect to the assets, liabilities, revenues and/or expenses of the entity (the basis for joint operation accounting) differ from its percentage ownership interest in the entity as a whole (the basis for proportionate consolidation).

### D.3 Comparison of certain aspects of joint venture accounting

The table below compares certain aspects of joint venture accounting for entities that meet the characteristics of a joint venture in both IFRS and US GAAP.

<table>
<thead>
<tr>
<th>Topic</th>
<th>US GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting by an investor for its interest in a joint venture</td>
<td>An investor generally accounts for its interest in a joint venture using the equity method of accounting. In addition, an investor is given the option to account for its interest at fair value, if certain conditions are met (see Section 5.11 of our FRD publication, <em>Equity method investments</em>, for additional guidance). In limited circumstances, an investor may use proportionate consolidation to account for its interest in an unincorporated entity in certain industries where it is an established practice (i.e., in the construction and extractive industries). See Section 3.4.2 of our FRD <em>Equity method investments</em>, for additional guidance. Refer to Appendix D of our FRD publication, <em>Equity method investments</em> for a table comparing certain aspects of equity method accounting in ASC 323 (US GAAP) and IAS 28 (IFRS).</td>
<td>An investor generally accounts for its interest in a joint venture using the equity method of accounting. An investor cannot elect to account for its interest at fair value, unless the investor is a venture capital organization, mutual fund or unit trust (or similar entity), or is an investment entity (as defined in IFRS 10). An investor cannot elect to account for its interest in a joint venture using proportionate consolidation. Refer to Appendix D of our FRD publication, <em>Equity method investments</em> for a table comparing certain aspects of equity method accounting in ASC 323 (US GAAP) and IAS 28 (IFRS).</td>
</tr>
<tr>
<td>Topic</td>
<td>US GAAP</td>
<td>IFRS</td>
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<td>----------------------------------------------------------------------</td>
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<tr>
<td>Accounting applied by investors for nonmonetary exchanges with a joint venture</td>
<td>The accounting generally would depend on whether the contribution meets the definition of a business or a nonprofit activity. The investor could recognize a full gain or loss on contributions of businesses or nonprofit activities (with certain scope exceptions). For other contributions or for contributions of businesses and nonprofit activities subject to certain scope exceptions, the accounting, including the amount of any gain or loss recognized, may depend on the nature of the asset contributed and whether any cash was also exchanged. This guidance is discussed further in Chapter 4.</td>
<td>If an investor contributes assets, the investor would be limited to recognizing only a partial gain, pursuant to IAS 28. However, if the investor contributes an interest in a subsidiary, the investor has a policy choice of recognizing either a partial gain or a full gain, given conflicting guidance for these transactions between IFRS 10 and IAS 28.24</td>
</tr>
<tr>
<td>Accounting applied by the joint venture when recognizing assets contributed at formation</td>
<td>Neither IFRS nor US GAAP directly addresses the accounting applied by the joint venture when recognizing assets contributed at formation. Either a carryover basis approach or a fair value approach may be appropriate under both US GAAP and IFRS, depending on the facts and circumstances. Nonetheless, given the lack of authoritative guidance and the need to apply other guidance by analogy, differences could arise between US GAAP and IFRS when applying either of these approaches.</td>
<td></td>
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24 In September 2014, the IASB issued Sale or Contribution of Assets between an Investor and its Associate or Joint Venture, Amendments to IFRS 10 and IAS 28. This amendment requires recognition of a full gain or loss from a sale or contribution of assets that constitute a business, between an investor and its associates or joint ventures and partial gain or loss from a sale or contribution of assets that do not constitute a business, between an investor and its associates or joint ventures. The amendment is applicable for annual periods beginning on or after 1 January 2016. Early adoption is permitted.
Summary of important changes

The following highlights important changes to this FRD since the June 2014 edition:

Chapter 2: Identifying a joint venture
- Section 2.1 was updated to reflect a recent speech made by SEC staff on the definition of a joint venture and to provide a flow chart on how to identify a joint venture.

Chapter 3: Accounting by the joint venture at formation
- Section 3.1, Section 3.1.2 and Section 3.1.3.2 were updated to reflect a recent speech made by the SEC staff on the accounting by a joint venture in a formation transaction.

Chapter 5: Disclosure requirements
- Section 5.3 was added to provide guidance on SEC reporting considerations.

Appendix D: Comparison of US GAAP to IFRS
- Section D.3 was updated for the issuance of Sale or Contribution of Assets between an Investor and its Associate or Joint Venture, Amendments to IFRS 10 and IAS 28, by the IASB.
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