Chapter 3

Accounting for and Reporting Investments in Construction Joint Ventures

3.01 As noted in chapter 1, "Industry Background," contractors frequently participate in construction joint ventures with other parties to share risks, combine financial and other resources, or obtain financing or bonding. The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) glossary defines a joint venture as an entity owned and operated by a small group of businesses (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A government may also be a member of the group. The purpose of a joint venture frequently is to share risks and rewards in developing a new market, product, or technology; to combine complimentary technological knowledge; or to pool resources in developing production or other facilities. Examples of such arrangements may involve the combination of a nonlocal entity having a customer relationship or expertise with a local contractor who is qualified to construct the project and has labor in the local market, two or more contractors with unique skills, or contractors creating an arrangement to be able to have sufficient bonding capacity for very large projects. A joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers, thus, have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a joint venture. The ownership of a joint venture seldom changes, and its equity interests usually are not traded publicly. A minority public ownership, however, does not preclude an entity from being a joint venture. As distinguished from a corporate joint venture, a joint venture is not limited to corporate entities.

3.02 Entities described as construction joint ventures vary in their legal forms. They include corporations, general and limited partnerships, limited liability companies, and undivided interests. The entities, which are usually project oriented, are often viewed as joint ventures even though one of the investors may have a majority voting interest or may otherwise have effective control of the entity. Because this chapter presents guidance on accounting for investments in entities described as construction joint ventures, questions relating to the existence of control are also addressed.

Joint Venture Accounting

Accounting Methods

3.03 According to FASB ASC 323-10-05-4, investments in the stock of entities other than subsidiaries, namely corporate joint ventures and other non-controlled entities, usually are accounted for using either the equity method, the cost method, or the fair value method. As explained in FASB ASC 323-10-15-3, the guidance in FASB ASC 323, Investments—Equity Method and Joint Ventures, applies to investments in 50 percent or less of the common stock or in-substance common stock (or both common stock and in-substance common stock). The FASB ASC glossary defines in-substance common stock as
an investment in an entity that has risk and reward characteristics that are substantially similar to that entity's common stock.

3.04 FASB ASC 323-10-05-5 establishes that the equity method tends to be the most appropriate if an investment enables the investor to influence the operating or financial decisions of the investee. As further explained in FASB ASC 323-10-15-8, an investment (direct or indirect) of 20 percent or more of the voting stock of an investee creates the presumption that in the absence of predominant evidence to the contrary, an investor has the ability to exercise significant influence over an investee. Conversely, an investment of less than 20 percent of the voting stock of an investee creates the presumption that an investor does not have the ability to exercise significant influence unless such ability can be demonstrated. Determining the ability of an investor to exercise significant influence is not always clear, and applying judgment is necessary to assess the status of each investment. Paragraphs 6–11 of FASB ASC 323-10-15 define significant influence.

3.05 FASB ASC 323-10-25-2 cautions that the equity method is not a valid substitute for consolidation. Consolidation is defined by the FASB ASC glossary as the presentation of a single set of amounts for an entire reporting entity. Consolidation requires elimination of intraentity transactions and balances. FASB ASC 323-10-25-2 also cautions that there are certain other limitations to the use of the equity method identified in paragraphs 8 and 10 of FASB ASC 810-10-15 including, but not limited to, circumstances in which the relevant provisions applicable to variable interest entities (VIEs) in FASB ASC 810, Consolidation, apply.

3.06 FASB ASC 325-20-35-3 explains that investments in joint ventures of less than 20 percent of the voting stock are presumed to indicate an investor's inability to exercise significant influence in the absence of predominant evidence to the contrary, in which case the use of the cost method is generally followed. FASB ASC 323-10-15-9 clarifies that an investor's voting stock interest in an investee should be based on those currently outstanding securities whose holders have present voting privileges. Potential voting privileges that may become available to holders of securities of an investee should be disregarded.

3.07 The fair value method of accounting for equity investments is normally not applicable to investments in joint ventures because it requires the availability of readily determinable fair values for the equity securities as noted in FASB ASC 320-10-15-5, and it is not available if the investments otherwise meet the criteria for the use of the cost method or equity method as noted in FASB ASC 320-10-15-7.

**Capital Contributions to Joint Ventures and Initial Measurement of Investments in Joint Ventures**

3.08 Unless certain exceptions in FASB ASC 323-10-30-2 apply, under the equity method, an investor should recognize an investment in a joint venture initially at cost, in accordance with FASB ASC 805-50-30.\(^1\)

3.09 Cash capital contributions to a venture by a venturer should be recorded by the venturer as an investment in the amount of the cash

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\(^1\) Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 325-20-30-1 explains that under the cost method, an investee will recognize a similar investment in the stock of an investee as an asset measured initially at cost.
contributed. As a general rule, the contribution of other assets should be recorded as an investment equal to the contributed asset's net book value on the venturer's books. That basis should be used regardless of the nature of the interest in the venture obtained from the transaction.

3.10 FASB ASC 845-10-15-4 clarifies that the guidance in FASB ASC 845, Nonmonetary Transactions, does not apply to a transfer of nonmonetary assets solely between a corporate joint venture and its owners, nor does it apply to a transfer of assets to an entity in exchange for an equity interest in that entity, including the exchange of a nonfinancial asset for a noncontrolling ownership interest in a joint venture. Moreover, FASB ASC 845-10-15-14 clarifies that the guidance in FASB ASC 845 pertaining to nonmonetary exchanges involving monetary consideration (referred to as boot) does not apply to transfers between a joint venture and its owners. Note that the FASB ASC glossary defines nonmonetary assets and liabilities as assets and liabilities other than monetary ones and monetary assets and liabilities as assets and liabilities whose amounts are fixed in terms of units of currency by contract or otherwise. Additionally, the FASB ASC glossary defines an exchange (or exchange transaction) as a reciprocal transfer between two entities that results in one of the entity's acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations.

3.11 A noncash contribution may be accompanied by a cash withdrawal by the contributing venturer. The receipt of cash may represent monetary consideration on which the venturer should recognize profit to the extent of the other venturers' proportionate interests.

3.12 The following illustrates a transaction in which the contributing venturer should recognize profit:

A and B are to share equally in a new joint venture. A contributes $100,000 in cash, and B contributes equipment with carrying value to him of $140,000. To equalize the contributions, A and B agree that B will withdraw $40,000 from the venture. The conditions required for proportionate profit recognition by B are present.

**Results**

1. The transaction indicates that the equipment has a fair value of $200,000.

2. B now effectively owns a 50 percent interest in the equipment.

3. B, therefore, has effectively sold a 50 percent interest in the equipment to A for $100,000 and should recognize a gain before income taxes of $30,000, that is, $100,000 - (1/2 x $140,000).

4. B should recognize an additional $30,000 as a gain as the venture depreciates the equipment. The venture would initially record the equipment on its books at its indicated fair value of $200,000.

3.13 A venturer may contribute assets to a venture and obtain an interest in the venture smaller than the carrying amount of contributed assets, based on the relationship of the carrying amount of the asset to the cash contributed by the other venturers. In those circumstances, the transaction might provide evidence that the cost or carrying amount of the contributed assets is greater
than their fair value, and that a loss should be recognized. Under the general principle that all losses should be recognized when they become evident, an indicated loss should be recognized by the venturer, with a corresponding reduction in the carrying amount of its investment in the venture. In measuring fair value, refer to the discussion in chapter 2, "Accounting for Performance of Construction-Type Contracts."

3.14 The following is an illustration of a transaction in which a venturer should recognize a loss:

A and B are to share equally in a new joint venture. A contributes $100,000 in cash, and B contributes equipment with a carrying value to him of $140,000.

Results

1. The transaction indicates that the equipment has a fair value of $100,000 (the amount of A's contribution).
2. B should recognize a loss of $40,000 and record its investment in the venture at $100,000.

3.15 A venturer may obtain an interest in a venture by contributing service or "know-how." If the services are to be provided in the future, the cost should not be assigned to the investment account until the services are performed. Recognition of the venturer's share of the profits on withdrawals received before the performance of the services should be deferred until the services are performed and the earning process is complete.

Sales to a Venture

3.16 Sales of materials, supplies, or services to a venture by a venturer that controls the venture, through majority voting interest or otherwise, generally should not be viewed as arm's length transactions. The venturer should not recognize as income any of the intercompany profit or loss from such transactions until it has been realized through transactions with outside third parties.

3.17 FASB ASC 323-10-35-10 states that when an investor controls an investee through majority voting interest and enters into a transaction with an investee that is not on at arm's length, none of the intraentity profit or loss from the transaction should be recognized in income by the investor until it has been realized through transactions with third parties. The same treatment also applies for an investee established with the cooperation of an investor (including an investee established for the financing and operation or leasing of property sold to the investee by the investor) if control is exercised through guarantees of indebtedness, extension of credit and other special arrangements by the

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2 FASB ASC 460-10-50-6 states that some guarantees are issued to benefit entities that are related parties such as joint ventures, equity method investees, and certain entities for which the controlling financial interest cannot be assessed by analyzing voting interests. In those cases, the disclosures required by FASB ASC 460, Guarantees, are incremental to the disclosures required by FASB ASC 850, Related Party Disclosures. FASB ASC 460-10-25-4 clarifies that a guarantor should recognize in its statement of financial position, at the inception of a guarantee, a liability for that guarantee. The offsetting entry depends on the circumstances in which the guarantee was issued. Among other circumstances described in FASB ASC 460-10-55-23, a guarantee issued in conjunction with the formation of a partially owned business or a venture accounted for under the equity method results in an increase to the carrying amount of the investment. FASB ASC 460-10-25-1 clarifies a guarantee issued either between parents and their subsidiaries or between corporations under common control are not subject to the recognition provisions of FASB ASC 460.
Investments in Construction Joint Ventures

in the benefit of the investee, or because of ownership by the investor of warrants, convertible securities, and so forth issued by the investee.

3.18 However, a transaction may be deemed to be on an arm's-length basis, which means that is the price that would be received to sell the property in an orderly transaction between market participants who are independent of the reporting entity. A controlling venturer may recognize profit to the extent of other interests in the venture if the following conditions are met:

- The transaction was entered into at a price determinable on an arm's length basis; that is, fair value can be measured by comparable sales at normal selling prices to independent third parties or by competitive bids. As provided by "Pending Content" in FASB ASC 820-10-35-3, a fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions. "Pending Content" in the FASB ASC glossary defines market participants as buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:
  - They are independent of each other, that is, they are not related parties, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms.
  - They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.

- They are able to enter into a transaction for the asset or liability. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so. No substantial uncertainties exist regarding the venturer's ability to perform, such as those that may be present if the venturer lacks experience in the business of the venture or regarding the total cost of the services to be rendered.

- The venture is creditworthy and has independent financial substance.

3.19 A venturer that does not control the venture should recognize intercompany profit to the extent of other interests in the venture.

Subsequent Measurement and Presentation of Investments in Joint Ventures

3.20 At least five different methods of presenting a venturer's interest in a venture are followed in present practice:

- Consolidation. The venture is fully consolidated, with the other venturers' interests shown as noncontrolling interests.
Partial or proportionate consolidation. The venturer records its proportionate interest in the venture's assets, liabilities, revenues, and expenses on a line-by-line basis and combines the amounts directly with its own assets, liabilities, revenues, and expenses without distinguishing between the amounts related to the venture and those held directly by the venturer. Paragraph 14 of FASB ASC 810-10-45 provides that an investee in the construction industry may present its investment in an unincorporated legal entity accounted for by the equity method using the proportionate gross financial statement presentation.

Expanded equity method. The venturer presents its proportionate share of the venture's assets and liabilities in capsule form, segregated between current and noncurrent. The elements of the investment are presented separately by including the venturer's equity in the venture's corresponding items under current assets, current liabilities, noncurrent assets, noncurrent liabilities, revenues, and expenses, using a caption such as "investor's share of net current assets of joint ventures."

Equity method. Paragraphs 1–2 of FASB ASC 323-10-45 establish that an investment accounted for under the equity method of accounting should be shown in the balance sheet of an investor as a single amount. Likewise, an investor's share of earnings or losses from its investment shall be shown in its income statement as a single amount, except for an investor's share of extraordinary items, those which meet the criteria of FASB ASC 225-20-45-3, and its share of accounting changes reported in the financial statements of the investee, which should be classified separately in accordance with FASB ASC 225-20. An investor should recognize its share of the earnings or losses of an investee based on the shares of common stock and in-substance common stock held by that investor, as set forth in FASB ASC 323-10-35-4, in the periods for which they are reported by the investee in its financial statements. An investor should adjust the carrying amount of an investment for its share of the earnings or losses of the investee after the date of investment and shall report the recognized earnings or losses in income. Paragraphs 31–32 of FASB ASC 323-10-35 explain that a loss in value of an equity method investment that is other than a temporary decline should be recognized even though the decrease in value is in excess of what would otherwise be recognized by application of the equity method. A series of operating losses of an investee or other factors may indicate that an other than temporary decrease in value of the investment has occurred. FASB ASC 323-10-35-32A states that an equity method investor should not separately test an investee's underlying asset(s) for impairment. However, an equity investor should recognize its share of any impairment charge recorded by an investee in accordance with the guidance in FASB ASC 323-10-35-13 and FASB ASC 323-10-45-1

3 Paragraphs 37–39 of FASB ASC 323-10-35 address how an investor should account for its proportionate share of an investee's equity adjustments for other comprehensive income upon a loss of significant influence, a loss of control that results in the retention of a cost method investment, and discontinuation of the equity method for an investment in a limited partnership because the conditions in FASB ASC 970-323-25-6 are met for applying the cost method.
and consider the effect, if any, of the impairment on the investor's basis difference in the assets giving rise to the investee's impairment charge.

- **Cost method.** As provided in FASB ASC 325-20-35-1, under the cost method of accounting for investments in common stock, dividends are the basis for recognition by an investor of earnings from an investment. An investor recognizes as income dividends received that are distributed from net accumulated earnings of the investee since the date of acquisition by the investor. The net accumulated earnings of an investee subsequent to the date of investment are recognized by the investor only to the extent distributed by the investee as dividends. Dividends received in excess of earnings subsequent to the date of investment are considered a return of investment and are recorded as reductions of cost of the investment. As with equity method investments, FASB ASC 325-20-35-2 explains that a loss in value of a cost method investment that is other than a temporary decline should be recognized. A series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred that is other than temporary.

3.21 The extent of the use of those methods varies; however, they have all been used in, or have been considered acceptable for use in, accounting for investments in joint ventures in the construction industry. Combinations of those methods have also been used in the construction industry. As noted previously, a common combination is to use the one-line equity method in the balance sheet and the proportionate consolidation method in the income statement.

**Corporate Joint Ventures**

3.22 Paragraph 3 of FASB ASC 323-10-15 establishes that the equity method of accounting applies to investments in the common stock of corporate joint ventures. FASB ASC 323-10 provides guidance and establishes requirements on the application of the equity method. According to FASB ASC 323-10-05-4, the equity method of accounting more closely meets the objectives of accrual accounting than does the cost method because the investor recognizes its share of the earnings and losses of the investee in the periods in which they are reflected in the accounts of the investee. The equity method also best enables investors in corporate joint ventures to reflect the underlying nature of their investment in those ventures.4

3.23 In its definition of a corporate joint venture, the FASB ASC glossary explains an entity that is a subsidiary of one of the joint venturers is not a corporate joint venture. A subsidiary, according to the FASB ASC glossary, is an entity, including an unincorporated entity, such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest, including a VIE that is consolidated by a primary beneficiary.

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4 FASB ASC 810-10-45-13 establishes that a parent or an investor should report a change to (or the elimination of) a previously existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee in the parent's or investor's consolidated financial statements as a change in accounting principle in accordance with the provisions of FASB ASC 250, Accounting Changes and Error Corrections. This issue does not apply in situations in which a parent entity or an investor changes its fiscal year-end.
3.24 With limited exceptions, all majority-owned subsidiaries—that is, all entities in which a parent has a controlling financial interest—should be consolidated in accordance with FASB ASC 810-10-15-10(a). FASB ASC 810-10-15-10(a)(1) states that a majority-owned subsidiary should not be consolidated if control does not rest with the majority owner, and provides indicators of when this situation may be present.

Variable Interest Entities

3.25 FASB ASC 810-10 provides guidance and establishes requirements pertaining to the consolidation of VIEs, defined by the FASB ASC glossary as entities subject to consolidation according to the applicable subsections in FASB ASC 810-10 related to VIEs. This FASB ASC subtopic explains how to apply the consolidation guidance of FASB ASC 810 to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. The FASB ASC glossary term subordinated financial support is defined as variable interests that will absorb some or all of a VIE's expected losses. "Pending Content" in FASB ASC 810-10-15-14 states that an entity should follow the consolidation guidance for VIEs in FASB ASC 810-10 if, by design, any of the following conditions exist:

a. The total equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support provided by any parties, including equity holders.

b. As a group, the holders of the equity investment at risk lack any one of the following three characteristics:

i. The power, through voting rights or similar rights, to direct the activities of a legal entity that most significantly impact the entity's economic performance;

ii. The obligation to absorb the expected losses of the legal entity;

iii. The right to receive the expected residual returns of the legal entity;

c. The equity investors as a group otherwise lack the characteristic noted in the preceding item (b)(i) as a result of both of the following conditions being present:

i. The voting rights of some investors are not proportional to their obligations to absorb the expected losses of the legal entity, their rights to receive the expected residual returns of the legal entity, or both.

ii. Substantially all of the legal entity's activities (for example, providing financing or buying assets) either involve or

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6 Among other significant provisions, "Pending Content" in FASB ASC 810-10-15-14 notes that kick-out rights or participating rights held by the holders of the equity investment at risk shall not prevent interests other than the equity investment from having this characteristic unless a single equity holder (including its related parties and de facto agents) has the unilateral ability to exercise such rights. Alternatively, interests other than the equity investment at risk that provide the holders of those interests with kick-out rights or participating rights should not prevent the equity holders from having this characteristic unless a single reporting entity (including its related parties and de facto agents) has the unilateral ability to exercise those rights.
are conducted on behalf of an investor that has disproportionately few voting rights.

3.26 FASB ASC 810-10 may affect the way construction contractors account for and report their investments in construction joint ventures. As provided in "Pending Content" in FASB ASC 810-10-25-38, an entity shall consolidate a VIE when that reporting entity has a variable interest (or combination of variable interests) that provide the entity with a controlling financial interest on the basis of the provisions of "Pending Content" in paragraphs 38A–38G of FASB ASC 810-10-25, as discussed in paragraphs 3.27–28. The entity that consolidates a VIE is called the primary beneficiary of that VIE according to "Pending Content" in the FASB ASC glossary.

3.27 "Pending Content" in FASB ASC 810-10-25-38A states that an entity with a variable interest in a VIE should assess whether it has a controlling financial interest in the VIE and, thus, is the VIE's primary beneficiary. The entity is deemed to have a controlling interest if it has both of the following characteristics:

- The power to direct the activities of the VIE that most significantly impact the VIE's economic performance
- The obligation to absorb the losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE

Only one reporting entity is expected to be identified as the primary beneficiary of a VIE, although several may have the characteristics of the second item in the preceding list. Only one entity will have the power to direct the activities of the VIE that most significantly impact the VIE's economic performance.

3.28 "Pending Content" in FASB ASC 810-10-25-38B states that an entity is not required to exercise the power it holds over a VIE, as established in paragraph 3.27, in order to have power to direct the activities of a VIE.

Initial Consolidation of a Variable Interest Entity

3.29 If the primary beneficiary of a VIE and the VIE itself are under common control, the primary beneficiary should initially measure the assets, liabilities, and noncontrolling interests of the VIE at amounts at which they

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6 Paragraph 14 of FASB ASC 810-10-45 provides that an investee in the construction industry may present its investment in an unincorporated legal entity accounted for by the equity method using the proportionate gross financial statement presentation.

7 The use of a quantitative approach, as discussed in the FASB ASC glossary definitions of expected losses, expected residual returns, and expected variability is not required and should not be the sole determinant about whether the entity has those obligations or rights.

8 If the entity determines that power is, in fact, shared among multiple unrelated parties such that no one party has the power to direct the activities of the variable interest entity (VIE) that most significantly affect the VIE's economic performance, then no party is the primary beneficiary. Power is shared if two or more unrelated parties together have the power to direct the activities of a VIE that most significantly affect the VIE's economic performance and if decisions about those activities require the consent of each of the parties sharing power. If the entity concludes that power is not shared, but the activities that most significantly affect the VIE's economic performance are directed by multiple unrelated parties, and the nature of activities that each party is directing is the same, then the party, if any, with the power over the majority of those activities will be considered to have the characteristics in the first item in the bulleted list in paragraph 3.27.

However, if the activities that affect the VIE's economic performance are directed by multiple unrelated parties, and the nature of the activities that each party is directing is not the same, then the entity should identify which party has the power to direct the activities that most significantly affect the VIE's economic performance. Only one party will have this power.
are carried in the accounts of the reporting entity that controls the VIE. For situations in which the initial consolidation of a VIE is a business, the transaction is a business combination and should be accounted for under the provisions of FASB ASC 805, Business Combinations.

Initial Consolidation When Earlier Consolidation Was Prevented Due to Lack of Information

3.30 "Pending Content" in paragraphs 7–9 of FASB ASC 810-10-30 provide guidance to a reporting entity that has not applied the guidance in the "Variable Interest Entities" subsections of FASB ASC to a legal entity because earlier consolidation was prevented due to a lack of information as discussed in FASB ASC 810-10-15-17(c).

3.31 "Pending Content" in FASB ASC 810-10-30-8 clarifies that the initial measurement by the consolidating entity of the assets, liabilities, and noncontrolling interests of the VIE at the date the requirements of the VIE subsections in FASB ASC 810-10 first apply depends on whether the determination of their carrying amounts is practical. In this context, carrying amounts refers to the amounts at which the assets, liabilities, and noncontrolling interests would have been carried in the consolidated financial statements if the VIE subsections had been effective when the entity first met the conditions to be the primary beneficiary.

3.32 If determining the carrying amounts is practicable, the consolidating entity should initially measure the assets, liabilities, and noncontrolling interests of the VIE at their carrying amounts at the date the VIE subsections first apply.

3.33 If determining the carrying amounts is not practicable, the consolidating entity should initially measure the assets, liabilities, and noncontrolling interests of the VIE at their fair value at the date the VIE subsections first apply. As an alternative to this fair value measurement requirement, the assets and liabilities of the VIE may be measured at their unpaid principal balances at this same date, if both of the following conditions are met:

- The activities of the VIE are primarily related to securitizations or other forms of asset-backed financing.
- The assets of the VIE can be used only to settle obligations of the entity.

This measurement alternative does not obviate the need for the primary beneficiary to recognize any accrued interest, an allowance for credit losses, or other-than-temporary impairment, as appropriate. Other assets, liabilities, or noncontrolling interests, if any, that do not have an unpaid principal balance and any items that are required to be carried at fair value under other applicable standards should be measured at fair value.

3.34 Any difference between the net amount added to the balance sheet of the consolidating entity and the amount of any previously recognized interest in the newly consolidated VIE would be recognized as a cumulative effect of an accounting change.

3.35 In accordance with FASB ASC 810-10-35-3, after the initial measurement, the assets, liabilities, and noncontrolling interests of a consolidated VIE should be accounted for in consolidated financial statements as if the VIE were
consolidated based upon voting interests. Any specialized accounting requirements applicable to the type of business in which the VIE operates should be applied as they would be applied to a consolidated subsidiary. The consolidated entity should follow the requirements for elimination of intraentity balances and transactions and other matters described in FASB ASC 810-10-45, FASB ASC 810-10-50-1, and FASB ASC 810-10-50-1B, as well as existing practices for consolidated subsidiaries. Fees or other sources of income or expense between a primary beneficiary and a consolidated VIE should be eliminated against the related expense or income of the VIE. The resulting effect of that elimination on the net income or expense of the VIE should be attributed to the primary beneficiary (and not to noncontrolling interests) in the consolidated financial statements.

3.36 In accordance with FASB ASC 810-10-45-16, the noncontrolling interest should be reported in the consolidated statement of financial position within equity (net assets), separately from the parent's equity (or net assets). The amount should be clearly identified and labeled, for example, as noncontrolling interest in subsidiaries. An entity with noncontrolling interests in more than one subsidiary may present those interests in aggregate in the consolidated financial statements.

General Partnerships

3.37 FASB ASC 323-30-25-1 states that investors in unincorporated entities, such as partnerships, generally should account for their investments using the equity method of accounting by analogy to FASB ASC 323-10 if the investor has the ability to exercise significant influence over the investee.

3.38 The principal difference, aside from income tax considerations, between corporate joint ventures and general partnerships is that a condition that would usually indicate control of a general partnership is ownership of a majority (over 50 percent) of the financial interests in profits or losses. The power to control a general partnership may also exist with a lesser percentage of ownership, for example, by contract, by agreement with other partners, or by court decree. On the other hand, majority ownership may not constitute control if major decisions such as the acquisition, sale, or refinancing of principal partnership assets must be approved by one or more of the other partners.

Limited Partnerships

3.39 FASB ASC 810-10-15-10(b) states that FASB ASC 810-20, which discusses control of partnerships, should be applied to determine whether the rights of the limited partners in a limited partnership overcome the presumption that the general partner controls, and therefore should consolidate, the partnership. According to FASB ASC 810-20-15-3, the guidance in FASB ASC 810-20 does not apply to the following entities:

- Limited partnerships or similar entities (such as limited liability companies that have governing provisions that are the functional equivalent of a limited partnership) that are entities within the scope of the VIE subsections of FASB ASC 810-10

- A general partner that, in accordance with generally accepted accounting principles (GAAP) of the United States, carries its investment in the limited partnership at fair value with changes in fair value reported in a statement of operations or financial performance

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3.40 The accounting recommendations for investments in general partnerships are generally appropriate for accounting by limited partners for their investments in limited partnerships. However, a limited partner's interest may be so minor that the investor may have virtually no influence over partnership operating and financial policies. Such a limited partner is, in substance, in the same position relative to the investment as an investor that owns a minor common stock interest in a corporation, and, accordingly, accounting for the investment using the cost method may be appropriate.

3.41 Paragraphs 1–3 of FASB ASC 810-20-25 clarify that the determination of which, if any, general partner within the group controls and, therefore, shall consolidate the limited partnership is based on an analysis of the relevant facts and circumstances. In situations involving multiple general partners, entities under common control are considered to be a single general partner for purposes of applying the guidance in FASB ASC 810-20. The general partners in a limited partnership are presumed to control that limited partnership regardless of the extent of the general partners' ownership interest in the limited partnership.

3.42 However, if the substance of the partnership arrangement is such that the general partners are not in control of the partnership's major operating and financial policies, a limited partner may be in control. An example could be a limited partner holding over 50 percent of the total partnership interest.

3.43 As provided in FASB ASC 810-10-15-10, the guidance in FASB ASC 810-20 should be applied to determine whether the rights of the limited partners in a limited partnership overcome the presumption that the general partner controls, and therefore should consolidate, the partnership. If, based on the criteria set forth in FASB ASC 810-20, presumption of control by the general partners can be overcome, then each of the general partners would account for its investment in the limited partnership using the equity method of accounting.10

9 FASB ASC 323-30-S99-1 states that the Securities and Exchange Commission (SEC) staff's position on all investments in limited partnerships is that these investments should be accounted for using the equity method unless the investor's interest "is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The SEC staff understands that practice generally has viewed investments of more than 3 percent to 5 percent to be more than minor.

10 Paragraphs 4–20 of FASB ASC 810-20-25 establish certain rights held by limited partner(s) that would overcome the presumption of control by the general partners. The assessment of whether the rights of the limited partners shall overcome the presumption of control by the general partners is a matter of judgment that depends on facts and circumstances. The general partners do not control the limited partnership if the limited partners have (a) the substantive ability to dissolve (liquidate) the limited partnership or otherwise remove the general partners without cause, (b) substantive participating rights, (c) substantive kick-out rights, and (d) protective rights that provide the limited partners with the right to effectively participate in significant decisions that would be expected to be made in the ordinary course of the limited partnership's business while being protective of the limited partners' investment. Refer to the FASB ASC glossary for definitions of the aforementioned terms and to FASB ASC paragraphs noted initially for further guidance.
Undivided Interests in Ventures

3.44 FASB ASC 323-30-15-3 clarifies that investments in partnerships and unincorporated joint ventures may also be called undivided interests in ventures. According to FASB ASC 810-10-45-14, if the investor-venturer owns an undivided interest in each asset and is proportionately liable for its share of each liability, the provisions of FASB ASC 323-10-45-1 relating to the application of the equity method of accounting may not apply to investees in the construction industry. For example, proportionate consolidation using a proportionate gross financial statement presentation wherein the investor-venturer accounts in its financial statements for its pro rata share of the assets, liabilities, revenues, and expenses of the venture may be appropriate.

Determining Venturers' Percentage Ownership

3.45 Many joint venture agreements designate different allocations among the venturers of (a) the profits and losses, (b) the specified costs and expenses or revenues, (c) the distributions of cash from operations, and (d) the distributions of cash proceeds from liquidation. Such agreements may also provide for changes in the allocations at specified future dates or on the occurrence of specified future events. For the purpose of determining the amount of income or loss to be recognized by the venturer, the percentage of ownership interest should be based on the percentage by which costs and profits will ultimately be shared by the venturers. An exception to this general rule may be appropriate if changes in the percentages are scheduled or expected to occur so far in the future that they become meaningless for current reporting purposes. In those circumstances, the percentage interest specified in the joint venture agreement should be used with appropriate disclosures.

Conforming the Accounting Principles of the Venture

3.46 The accounts of a venture may reflect accounting practices, such as those used to prepare tax basis data for investors, that vary from GAAP. If the financial statements of the investor are to be prepared in conformity with GAAP, such variances that are material should be identified and conformed to.

Losses in Excess of a Venturer's Investment, Loans, and Advances

3.47 A venturer should record its share of joint venture losses in excess of its investment, loans, and advances in accordance with paragraphs 19–30 of FASB ASC 323-10-35. An investor's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by the equity method plus advances made by the investor. An equity method investor should continue to report losses up to the investor's investment carrying amount, including any additional financial support made or committed to by the investor. Additional financial support made or committed to by the investor may take the form of any of the following:

- Capital contributions to the investee
- Investments in additional common stock of the investee
- Investments in preferred stock of the investee
Loans to the investee
Investments in debt securities (including mandatorily redeemable preferred stock) of the investee
Advances to the investee

The investor ordinarily should discontinue applying the equity method if the investment (and net advances) is reduced to zero and shall not provide for additional losses unless the investor has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee. Such circumstances may be evidenced by

- legal obligation as a guarantor\(^{11}\) or general partner.
- commitment based on such considerations as business reputation, intercompany relationships, and credit standing. Such a commitment might be evidenced by
  - previous support by the venturer indicating that it would make good joint venture obligations.
  - public statements by the venturer of its intention to provide support.

An investor should, however, provide for additional losses if the imminent return to profitable operations by an investee appears to be assured. For example, a material, nonrecurring loss of an isolated nature may reduce an investment below zero even though the underlying profitable operating pattern of an investee is unimpaired. If the investee subsequently reports net income, the investor should resume applying the equity method only after its share of that net income equals the share of net losses not recognized during the period the equity method was suspended. For additional guidance, refer to FASB ASC 323-10.

Disclosures in a Venturer’s Financial Statements

3.48 In addition to the presentation of the basic financial statements and required disclosures in those statements, paragraphs 1–3 of FASB ASC 323-10-50 describe additional disclosures relating to investments accounted for using the equity method of accounting. All of the following disclosure requirements generally apply to the equity method of accounting for investments in common stock:

- Financial statements of an investor should parenthetically disclose, in notes to financial statements or in separate statements or schedules,
  - the name of each investee and percentage of ownership of common stock.
  - the accounting policies of the investor with respect to investments in common stock. Disclosure shall include the names of any significant investee entities in which the investor holds 20 percent or more of the voting stock, but the common stock is not accounted for on the equity method, together with the reasons why the equity method

\(^{11}\) See footnote 3.
is not considered appropriate, and the names of any significant investee corporations in which the investor holds less than 20 percent of the voting stock and the common stock is accounted for on the equity method, together with the reasons why the equity method is considered appropriate.

- the difference, if any, between the amount at which an investment is carried and the amount of underlying equity in net assets and the accounting treatment of the difference.

- For those investments in common stock for which a quoted market price is available, the aggregate value of each identified investment based on the quoted market price usually shall be disclosed. This disclosure is not required for investments in common stock of subsidiaries.

- If investments in common stock of corporate joint ventures or other investments accounted for under the equity method are, in the aggregate, material in relation to the financial position or results of operations of an investor, it may be necessary for summarized information about assets, liabilities, and results of operations of the investees to be presented in the notes or in separate statements, either individually or in groups, as appropriate.

- Conversion of outstanding convertible securities, exercise of outstanding options and warrants, and other contingent issuances of an investee may have a significant effect on an investor's share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises, or contingent issuances shall be disclosed in notes to financial statements of an investor.

For disclosures related to consolidated financial statements and VIEs, readers should refer to the guidance in FASB ASC 810-10-50. When presenting financial statements that include cost-method investments, readers should refer to the guidance in FASB ASC 325-20-50.

3.49 Additional items that a venturer should consider for disclosure include

- any important provisions of the joint venture agreement.

- if the joint venture's financial statements are not fully consolidated with those of the venturer, separate or combined financial statements of the ventures in summary form, including disclosure of accounting principles of the ventures that differ significantly from those of the venturer.

- intercompany transactions during the period and the basis of intercompany billings and charges.

- liabilities and contingent liabilities arising from the joint venture arrangement, including venturer's obligations under guarantees.  

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12 See footnote 3.