ACCOUNTING FOR JOINT VENTURE FORMATION

Ex. 1 Contribution to JV in return for interest in JV

X contributes land worth $750,000 (BV= $400,000) and equipment worth $1,200,000 (BV = $600,000) in return for a 50% interest in the JV. Y contributes cash of $1,950,000 for a 50% interest in the JV. The equipment has a remaining useful life of 5 years.

What is the entry that should be recorded by X?

	DR	CR	
Investment in JV	$1,950,000		
Land (BV)		400,000	
Eqpt. (BV)		600,000	
Def'd gain, land (X's share)		175,000	- Eliminate on proportionate consolidation
Def'd gain, eqpt (X's share)		300,000	
Def'd gain, land (Y's share)		175,000	- Defer and amortize to income over life of
Def'd gain, eqpt (Y's share)		300,000	asset (eqpt) or venture (land)

Basic idea: recognize the other venturer's share of the gain, but only on a defer and amortize basis (no immediate recognition). Don't recognize your own portion of the gain, so reduce asset carrying values and depreciation to historic cost for this portion.

Ex. 2 **Contribution to JV in return for interest in JV plus cash**

X contributes land worth $750,000 (BV= $400,000) and equipment worth $1,200,000 (BV = $600,000) in return for a $700,000 in cash from the JV and a 50% interest in the JV, worth $1,250,000. Y contributes cash of $1,250,000 to the JV (of which $700,000 then goes to X) for a 50% interest in the JV, worth $1,250,000.

To see all this, contemplate the JV balance sheet upon formation:

Assets		Shareholder Equity	
Cash (from Y)	$550,000	Common Stock (X)	$1,250,000
Assets (from X)	1,950,000	Common Stock (Y)	1,250,000
	$2,500,000		$2,500,000

What is the entry that should be recorded by X?

$700,000 of the $1,950,000 FV received is in the form of cash. Therefore, there is culmination of the earnings process (ie, the gain is realized) to the extent of the cash proportion.

So, X takes $700,000 / $1,950,000 X $950,000 gain = $341,026 to income immediately. Another way to calculate this is:

Sales proceeds (= cash received)	$700,000
Related BV portion ($700,000/ $1,950,000 X $1,000,000)	358,974
Immediate gain ("culmination" to extent of cash)	341,026

The total dispostion of the $950,000 gain is as follows:

Portion recognized immediately	$341,026
Portion defer and amortize to income	133,974
Y's share of gain	475,000
X's share of gain (eliminate on proportionate consolidation)	475,000
	950,000

So, the entry by X on formation is as follows:

	DR	CR	
Cash	$700,000		
Investment in JV	$1,250,000		
Land (BV)		400,000	
Eqpt. (BV)		600,000	
Def'd gain, land (X's share)		175,000	- $475,000 eliminated on proportionate
Def'd gain, eqpt (X's share)		300,000	consolidation.
Gain, land*		125,641	- $341,026 recognized now
Gain, eqpt*		215,385	
Def'd gain, land		49,359	- $133,974 defer and amortize to income over life
Def'd gain, eqpt		84,615	of (eqpt), life of JV (land)

** Land and equipment gains are recognised based on relative total gains, e.g. land = $350,000 gain / $950,000 total gain x $341,026*

Ex.3 **<u>Contribution to JV in return for interest in JV plus cash, but some of the cash came from borrowings by the JV</u>**

X contributes land worth $5,000,000 (BV= $2,000,000) in return for $1,000,000 in cash from the JV and a 40% interest in the JV, worth $4,000,000. Y contributes $500,000 in cash to the JV in addition to other assets worth $5,500,000 for a 60% interest in the JV, worth $6,000,000. Upon formation, the JV borrowed $1,750,000 from the bank.

To see all this, contemplate the JV balance sheet upon formation:

Assets		Liabilities and Shareholder Equity	
Cash (from bank)	$1,250,000	Bank	$1,750,000
Other Assets (from Y)	5,500,000	Common Stock (X)	4,000,000
Land (from X)	5,000,000	Common Stock (Y)	6,000,000
	$11,750,000		$11,750,000

What is the immediate gain from contribution to the JV that X can recognize?

	DR	CR	
Land - FMV		$5,000,000	
- COST		2,000,000	
Total gain		$3,000,000	
X's share (40%)		$1,200,000	- eliminated against land on proportionate consolidation.
Gain to recognize now (800/5000) x 3,000,000*		480,000	- Y's share of gain
Gain to defer and amortize		1,320,000	
		3,000,000	
*Cash to X	1,000,000		
Cash to JV by Y	500,000		
= Cash to X from JV borrowings	500,000		
X's share of such borrowings (40%)	200,000		
So <u>net</u> cash to X is	1,000,000		
	(200,000)		
	$800,000		

ACCOUNTING FOR JOINT VENTURE FORMATION

Basic idea: the $200,000 of cash might have to be repaid to bank, which negates the cash receipt, (thus no immediate gain recognition for this portion).

The entry by X on formation is as follows:

	DR	CR	
Cash	$1,000,000		
Investment in JV	$4,000,000		
Def'd gain, land (X's share)		1,200,000	- eliminated on proportionate consolidation
Land (BV)		2,000,000	
Def'd gain, land		1,320,000	-.defer and amortise to income over JV life
Gain, land		480,000	- recognize now