Board Meeting Handout

Accounting by a Joint Venture for Nonmonetary Assets Contributed by Investors

January 22, 2020

Meeting Purpose

1. At the September 18, 2019 Board meeting, the Board decided to add to its technical agenda a narrow-scope project on accounting by a joint venture to address the initial recognition and measurement of nonmonetary assets contributed to the joint venture by investors. The January 22, 2020 Board meeting is a decision-making meeting for the Board to begin initial deliberations on the project.

Questions for the Board
1. Which approach does the Board support for the measurement of nonmonetary assets and businesses contributed to form a joint venture in the joint venture's financial statements: (a) Alternative A (carrying amount) (b) Alternative B (fair value) (c) Alternative C (optionality)? 2. Does the Board agree that any new guidance on joint ventures should be included in a proposed new Subtopic 805-60, Business Combinations—Joint Ventures?

Project Background

2. Given that the scope of the project addresses only entities that meet the definition of a joint venture (and a corporate joint venture) in the Master Glossary of the *FASB Accounting Standards Codification*®, the following Master Glossary definition has been included for reference:

> 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

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of the members of the group. A government may also be a member of the group. The purpose of a joint venture frequently is to share risks and rewards in developing a new market, product, or technology; to combine complementary technological knowledge; or to pool resources in developing production or other facilities. A joint venture also usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An entity that is a subsidiary of one of the joint venturers is not a joint venture. The ownership of a joint venture seldom changes, and its equity interests usually are not traded publicly. A minority public ownership, however, does not preclude an entity from being a joint venture. As distinguished from a corporate joint venture, a joint venture is not limited to corporate entities.

3. While joint ventures are defined in the Master Glossary, the accounting for a joint venture, specifically the initial recognition and measurement of nonmonetary assets contributed to that joint venture, is not currently addressed in the Codification. Joint venture accounting is specifically excluded from the scope of both Topic 845, Nonmonetary Transactions, and Topic 805, Business Combinations. In the absence of authoritative guidance by the Board, practice has been influenced by several speeches given by the U.S. Securities and Exchange Commission (SEC) staff.

4. After the Board's decision to add this project to its agenda, the staff completed outreach with 28 preparers, 6 practitioners, and several others, including a member of the Private Company Council (PCC), the American Institute of Certified Public Accountants' Technical Issues Committee (AICPA TIC), and members of the Small Business Advisory Committee (SBAC) and the PCC at their joint meeting in December 2019. Outreach with preparers targeted those from a wide breadth of industries in which joint ventures are commonly formed, including preparers from the real estate (including one industry association representing preparers), pharmaceutical, technology, and oil and gas industries, among others.

Alternatives

5. The following alternatives have been identified for the Board's consideration:

   (a) **Alternative A: Carrying Amount—**Upon formation, a joint venture should initially recognize and measure the contribution of nonmonetary assets at the venturers' carrying amounts in its financial statements.

   (b) **Alternative B: Fair Value—**Upon formation, a joint venture should initially recognize and measure the contribution of nonmonetary assets at fair value in its financial statements.

   (c) **Alternative C: Carrying Amount or Fair Value (Optionality)—**Upon formation, a joint venture may initially recognize and measure the contribution of all nonmonetary assets by their venturers at the respective venturers' carrying amount or at fair value in its financial statements.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Conceptual Framework—Elements
January 22, 2020

Meeting Purpose

1. At the January 22, 2020 decision-making Board meeting, the Board will discuss (a) the definitions of the terms *revenues*, *expenses*, *gains*, and *losses*, (b) the definitions of *investments by owners* and *distributions to owners*, (c) whether to proceed to drafting a proposed Concepts Statement elements chapter for vote by written ballot, and (d) the comment period for an Exposure Draft of the elements chapter.

Questions for the Board
Definitions of Revenues, Expenses, Gains, and Losses 1. Should the elements revenues, expenses, gains, and losses be defined as described below? Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities. Expenses are outflows or other using up of assets of an entity or incurrences of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out other activities. Gains are increases in equity (net assets) from transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners. Losses are decreases in equity (net assets) from transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners. **Definitions of Investments by and Distributions to Owners** 2. Does the Board want the proposed Concepts Statement chapter to retain the definitions of investments by and distributions to owners as defined in FASB Concepts Statement No. 6, *Elements of Financial Statements?*

Comment Period and Permission to Ballot

3. Does the Board give the staff permission to proceed to draft a proposed Concepts Statement chapter for vote by written ballot?

4. What comment period does the Board select for the proposed Concepts Statement chapter?

Issue 1: Definitions of Revenues, Expenses, Gains, and Losses

2. Concepts Statement 6 includes the element definitions of revenues, expenses, gains, and losses (together, the comprehensive income components), including discussion of how those elements differ from each other. The discussion is tenuous and inconclusive on how a Board member could distinguish between the revenue and gain or expense and loss definitions, and in Concepts Statement 6 the FASB seems to acknowledge that there could be shortcomings in those definitions. The shortcomings seem to be caused by certain problematic terms and phrases in the existing definitions.

3. The definitions of the terms *revenues* and *expenses* in Concepts Statement 6 are as follows:

> Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or *other activities* that constitute the *entity's ongoing major or central operations* (paragraph 78). [Emphasis added]
>
> Expenses are outflows or other using up of assets or incurrences of liabilities (or a combination of both) from delivering or producing goods, rendering services, or carrying out *other activities* that constitute the *entity's ongoing major or central operations* (paragraph 80). [Footnote reference omitted; emphasis added]

4. The definitions of the terms *gains* and *losses* in Concepts Statement 6 are as follows:

> Gains are increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners (paragraph 82).
>
> Losses are decreases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners (paragraph 83).

5. The problematic phrases in the definitions of revenue and expense are (a) the *entity's ongoing major or central operations* and (b) *other activities.*

6. The staff recommends the following definitions:

> Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or *carrying out other activities.*

> Expenses are outflows or other using up of assets of an entity or incurrences of its liabilities (or a combination of both) from delivering or producing goods, rendering services, *or carrying out other activities.*

7. The staff believes that its recommendation resolves the following issues:

   (a) *Other Activities*—This phrase is retained and made consistent in both the revenues and expenses proposed definitions by adding the phrase *carrying out* in the revenue definition. As explained previously, retaining that phrase allows sources such as investment income to be considered revenue and charitable contributions to be considered an expense. It is not the intent of the proposed definition to suggest that the phrase *other activities* is an all-encompassing notion that captures every inflow and outflow. The proposed concepts chapter will explain the purpose of the phrase and give examples for both for-profit entities and not-for-profit entities so that it is not misconstrued as all-encompassing.

   (b) *Ongoing Major or Central Operations*—To avoid emphasizing magnitude or centralized operations as the distinguishing feature between revenues and gains and expenses and losses, the proposed definitions would remove this phrase. Therefore, the proposed definitions of revenues and expenses would include all transactions that arise from delivering or producing goods or rendering services. Additionally, they would eliminate the confusion about whether this phrase relates only to the phrase *other activities*.

8. The proposed definitions of gains and losses are built from the definitions of revenues and expenses. As such, the staff recommends the following definitions:

> Gains are increases in equity (net assets) from transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.
>
> Losses are decreases in equity (net assets) from transactions and other events and circumstances affecting the entity except those that result from expenses or distributions to owners.

Issue 2: Definitions of Investments by and Distributions to Owners

9. Concepts Statement 6 defines investments by and distributions to owners as follows:

> Investments by owners are increases in equity of a particular business enterprise resulting from transfers to it from other entities of something valuable to obtain or increase ownership interests (or equity) in it (paragraph 66).
>
> Distributions to owners are decreases in equity of a particular business enterprise resulting from transferring assets, rendering services, or incurring liabilities by the enterprise to owners. Distributions to owners decrease ownership interest (or equity) in an enterprise (paragraph 67). [Footnote reference omitted]

10. The staff notes that the definitions of investments by and distributions to owners required clarification of what is meant by the term *owner*. That clarification was made at the November 13, 2019 meeting when the Board decided that the term *owner* should be explained as "the

holder of an instrument (or other arrangements, such as partnerships or proprietorships) that creates no obligation of the entity other than in liquidation." Because the term *owner* has been clarified by the Board, the staff notes that no significant issues associated with those elements remain.

Board Meeting Handout
Hedging—Last-of-Layer Method
January 22, 2020

Meeting Purpose

1. The January 22, 2020 Board meeting is a decision-making meeting on disclosures and transition related to the last-of-layer project. At the October 16, 2019 board meeting, the Board addressed two groups of issues:

   (a) Designating more than one hedging relationship associated with a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments

   (b) Accounting for fair value hedge basis adjustments in an existing last-of-layer hedge under both the single-hedge and proposed multiple-hedge models.

Questions for the Board
1. Does the Board think that the last-of-layer disclosures for the multiple-hedge model should be the same as those required under the single-hedge model? 2. Does the Board think that transition should be prospective for all proposed amendments except those related to disclosures with the staff's recommended transition provisions related to fair value hedge basis adjustments and documentation relief for last-of-layer hedges existing as of the date of adoption? 3. Does the Board think that entities should be able to elect to apply the proposed amendments related to disclosures outside of hedge accounting on either a full retrospective or prospective basis?

Disclosures

2. Accounting Standards Update No, 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* added paragraph 815-10-50-4EEE that requires that an entity disclose the following for each line item on the balance sheet that includes assets in a last-of-layer hedging relationship:

   (a) The amortized cost basis of the closed portfolio(s) of prepayable financial assets or the beneficial interest(s)

(b) The amount that represents the hedged item(s)

(c) The basis adjustment associated with the hedged item(s).

3. The Board added those disclosure requirements to provide users with information about the amounts that have been recognized as a result of applying fair value hedge accounting and about the unique nature of last-of-layer hedging relationships. As a result, users can understand the effect of last-of-layer hedges on the balance sheet and isolate the fair value hedging adjustments that will not affect future cash flows.

Transition

4. The proposed amendments, except for those related to disclosures required by Topics other than Topic 815, would be applied on a prospective basis.
   (a) Entities would be permitted to modify documentation without dedesignating an existing last-of-layer hedging relationship as of the date of adoption to add one or more hedges to the closed portfolio if the requirements for the amended last-of-layer method are met. In those cases, entities also would be permitted to modify documentation without dedesignating the existing hedging relationship to add the new elective documentation specifying the order in which multiple hedging relationships associated with the closed portfolio will be discontinued in the event of a breach.
   (b) Fair value hedge basis adjustments allocated to an asset that exists on an entity's balance sheet on the date of adoption would remain allocated to that asset over the remaining life of the asset. The fair value hedge basis adjustments allocated to those assets existing on the balance sheet on the date of adoption would be amortized over the remaining lives of the assets to which they were allocated in the same manner as any premium or discount associated with those assets. Any new fair value hedge basis adjustments recorded after the date of adoption would be maintained at the closed portfolio level.

5. Entities would have the option to apply the proposed amendments related to disclosures required by Topics other than Topic 815 on a prospective basis as of the date of adoption or on a full retrospective basis. Entities would be required to disclose the nature of and reason for the change in accounting principle in transition.

6. As a consequence of amending the treatment of last-of-layer fair value hedge basis adjustments in determining credit losses, some paragraphs amended by Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* also would be amended in this proposed Update. For entities that have not yet adopted Update 2016-13 as of the issuance

date of a final Update, the proposed amendments related to Update 2016-13 would be effective upon the adoption of Update 2016-13.