August 22, 2017

Joint Ventures in the Construction Industry

CONSTRUCTION
BY BRITTANY BECKER

The construction industry is constantly growing to meet the needs of the ever-evolving economy and world. According to Dun & Bradstreet's First Research Industry Database, US corporate profits, an indicator of corporate demand for construction services, rose 3.7% in the first quarter of 2017 compared to the same period in 2016 and the value of US nonresidential construction spending, a demand indicator for builders, rose 2.0% year-to-date in May 2017 compared to the same period in 2016. In order to compete, construction companies may specialize in a type of construction, region or even through the way in which they manage a project. Overall, companies are constantly exploring ways to take on new risks and challenges in order to find bigger and better projects.

Joint ventures are becoming an increasingly common way that a construction company can meet the demands of a large or more complex project. According to the Financial Accounting Standards Board, a joint venture is defined as an entity owned and operated by a small group of businesses (the joint ventures) as a separate and specific business or project for the mutual benefit of the members of the group. These types of arrangements are beneficial for several reasons, such as to:

- Share risks
- Combine financial resources such as financing or bonding
- Share skills such as engineering, design and construction

With such an arrangement also comes specific accounting treatment that should be considered depending on how much ownership the company has in the joint venture.

- Cost method – For companies with an investment of less than 20%, the cost method is typically utilized. Additionally, it is used when there is evidence that the company does not have the ability to exercise significant influence. Under the cost method, the initial investment is recorded on the balance sheet. Activity is only recorded to the extent the joint venture distributes dividends to the company.
- Equity method – For companies with an investment of less than 50%, but more than 20%, the equity method is typically utilized. The equity method is utilized when the company exercises significant influence over operational or financial decisions of the joint venture entity. This method presents the investment on the balance sheet adjusted for current-year operations, which are shown as a single amount on the income statement. Companies can also use the expanded equity method that presents the Company's proportionate share of the joint venture's current and noncurrent assets/liabilities as well as revenue and expenses.
- Consolidation - If a company owns more than a 50% ownership, the joint venture's operations are generally consolidated into the company's financial statements and the

other venturers’ interests are shown as noncontrolling interests. Companies also have an option to consolidate only the proportionate share of their interest in the joint venture’s assets, liabilities, revenues and expenses, line-by-line.

Entering into a joint venture arrangement can be very beneficial in a growing economy. Joint ventures can provide smaller companies more resources, knowledge, experience, capital and so on. However, companies should assess the impact that these arrangements can have on administration, accounting and financial reporting by discussing them with their audit and tax firm from the beginning.

If you have any questions relative to the use of joint ventures in the construction industry, please contact a member of the Schneider Downs Construction Industry Group.

You’ve heard our thoughts… We’d like to hear yours

The Schneider Downs Our Thoughts On blog exists to create a dialogue on issues that are important to organizations and individuals. While we enjoy sharing our ideas and insights, we’re especially interested in what you may have to say. If you have a question or a comment about this article – or any article from the Our Thoughts On blog – we hope you’ll share it with us. After all, a dialogue is an exchange of ideas, and we’d like to hear from you. Email us at contactSD@schneiderdowns.com.