Study Unit 3: Joint Venture

Learning Objectives

- To enter foreign market and even new or emerging market
- To reduce the risk factors for heavy investment,
- To make optimum utilization of resources
- To gain economies of scale
- To achieve synergy

INTRODUCTION

Joint ventures are primarily formed for construction of dams and roads, film production, buying and selling of goods etc.

A Joint Venture Accounting is used when two or more business wan to carry out a business venture together under a joint venture agreement.

A Joint Venture is a temporary partnership of two or more persons engaged in any particular business adventure of enterprise of shot or seasonal duration.

A Joint Venture is a contractual arrangement whereby two or more parties agree to share control over an economic activity.

Definition

Joint Venture may be defined as temporary partnership between two or more persons without the use of the firm name, limited to carry out a particular business plan in which persons concerned agree to share capital and profit and losses.

The persons who have so agreed to undertake a joint venture are known as co-ventures. A Joint Venture may consist of joint consignment of goods, speculation in shares, under writing of shares or debentures, construction of a building or any similar form of enterprise.

Under Joint Venture, the partners pool their assets and skills for the benefit of the company. Each partner typically has some authority to participate in their Joint Venture's management instead of' being only a passive investor. Each party also has responsibility for the costs associated with the venture, as well as sharing profits or losses. Joint Ventures are commonly used to invest if foreign and emerging market economies.

SALIENT FEATURES OF JOINT VENTURE

Agreement; two or more firms come to an agreement, to undertake a business, for a definite purpose and are bound by it.

Joint control: there exist a joint control of the co-ventures over business assets, operations, administration and even the venture.

Pooling of resources and expertise: firms pool their resources like capital, manpower, technical know-how and expertise, which helps in large scale production.

Sharing of profit and loss: the co-ventures agree to share the profits and losses of the business in an agreed ratio. The computation of the profit and loss is usually done at the end of the venture, however, when it continues for the long duration, the profit and loss is calculated annually.

Access to advanced technology: By entering into joint venture firms get access to various techniques of production, marketing and doing business, which decreases the overall cost and also improves quality.

Dissolution: Once the term or purpose of the joint venture is complete, the agreement comes to an end, and the accounts of the co-ventures are settled as and when it is dissolved.

The co-ventures are free to carry on their own business, unless otherwise provided in the joint venture agreement, during the life of the venture.

Going concern assumption of accounting is not appropriate for Joint Venture accounting. The problem of distinction between capital and revenue expenditure dose not rise.

Plant and machinery and other fixed assets, when used in a venture, are first charged to venture account at cost. On completion of the venture, such assets are re-valued and shown as the revenue of the venture. Thus, the accounting approach for measurement of venture profit is totally different.

Joint Venture follows cash basis of accounting

TYPES OF JOINT VENTURE

The type of joint venture is based on the various factors like the purpose for which it is formed, number of firms involved and the term for which it is formed.

The joint can be a merging of two different businesses or parties for a limited amount of time. This merge is usually set up when both parties want the connection between the two businesses to the public and well known among the business's customers or other business partners.

The joint venture can be created as a separate entity.

Two businesses or partners contribute their resources, assets, connections, and so on, into the joint venture, but the Joint Venture is not directly named after or associated with the partners involved. This is a good format for Joint Ventures that involve multiple partners or businesses.

There are different types of Joint Ventures. How you set up a joint venture depends on what your business is trying to achieve. The most types of joint venture are;

Limited co-operation; This is when you agree to collaborate with another business in a limited and specific way. For example, a small business with an exciting new product might want to sell it through a larger company's distribution network. The two partners agree a contract setting the terms and conditions of how this would work.

Separate joint venture business / full function Joint Ventures. This is when you set up a separate joint venture business, possibly a new company, to handle a particular contract. A joint venture company like this can be a very flexible option. The partners each own shares in the company and agree how they should manage it. It is sometimes called full function joint ventures as it performs all the functions of that autonomous entity on a lasting basis.

Business partnerships — in some cases, a limited company may not be the right choice. Instead you could even merge the two businesses.

Full scale world wide mergers

These are international joint ventures of a large scale, often with the involvement of international companies. A new company or subsidiary is created, for example, the merger between shell and Texaco resulted in equation to deal with a particular product (industrial lubricants).

Examples of joint ventures

As mentioned earlier the Joint Venture entities bring on table their own core competencies in order to achieve the mutual benefits.

Private companies gained access to resources / technical capabilities.

Government bodies for building infrastructure (Public Private Partnerships)

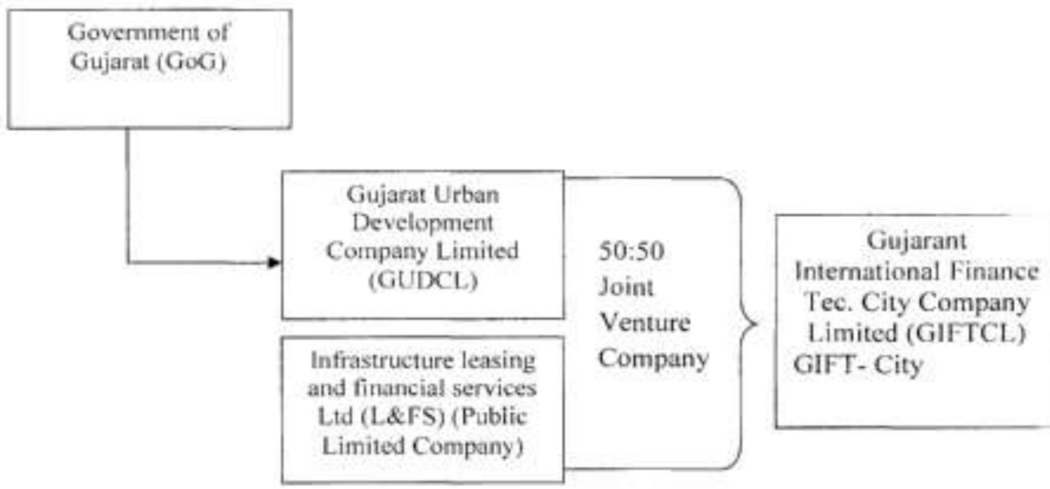
From the above types, the following examples were identified;

Google's verify life sciences Glaxosmith Wine Joint Venture. Google's parent company Alphabet and Glaxo Smith wine announced that they would associate themselves with a joint venture in the ratio of 45% - 55% to produce bio electronic medicines. Both of these companies got committed for 7 years and Euro 540 million.

Volvo Uber joint venture - recently volve and Uber have also announced that they would form a joint venture to produce self driving cars. The ratio would be 50% -50% as per the agreement; they are doing a $300 million investment for this joint venture.

#3- Bank’s digital currency joint venture recently, even banks formed a joint venture to create something new. Four worlds —class banks- deutsche bank, UBS, BNY Melon, and Santander came together in a joint venture to produce a new form of digital cash.

Gift —City a classic example of government and private joint venture for creating infrastructure.



From the above illustration- government of Gujarat through its undertaking GUDCL entered into joint venture with Public company for building world class infrastructure to create a hub for the global finance services industry. GOG benefited from infrastructure project execution capability of IL &Fs, while IL & FS received government backing which reduces the regulatory handles to certain extent.

STRUCTURES OF JOINT VENTURES

There are a number of Joint venture processes business can adopt. The potential structures include;

Entering into a contractual arrangement

Specific collaboration agreements between the parties

Establishment of a corporate joint venture through a limited company, or;

Creation of a general / limited liability partnership. These can be for a fixed term, or an at will' partnership (continuous until dissolution occurs) or created for a specific project so that the joint venture will end on completion of the project.

ADVANTAGES OF JOINT VENTURE

Forming a joint venture is successful and has unique benefits that make it an attractive option for some businesses and these include;

Shared resources and responsibilities. More often than not, a company enters into a joint venture because it lacks the required knowledge, human capital, technology or access to a specific market that s necessary to be successful in pursuing the project on its own. Coming together with another business affords each party access to the resources of the other participating company without having to spend excessive amounts of capital to obtain it.

Flexibility for participating companies- unlike a merger or acquisition, a joint venture is a temporary contract between participating companies that dissolves at a specific future date or when the project is completed. The companies entering into a business entity under which the project is then completed, providing a degree of flexibility not found in more permanent business strategies.

Shared business risk. Joint ventures also provide the benefit of shared risk spread among participating companies. The creation of a new product or delivery of a new service carries a great deal of risk for a business and many companies are not able to mange that risk alone. Under a joint venture, each company contributes a potion of the ventures needed to bring the product or services to market, making the heavy financial burden of research and development less of a challenge

The risk of the project failing and having a negative impact on profitability is lower because the costs associated with the project are distributed among each of the participating companies.

Form long lasting business relationships; even if the joint venture is s temporary arrangement, by associating with a business or two, you are able to form long-lasting business relationships with other associates.

Temporary agreement; a company has a perpetual entity. But in the case of Joint venture, two or more companies come together for a temporary agreement to produce something new. As a result, none of the companies is bound in the commitment for long period of time.

You will be able to sell your portion; 80% of all joint venture end up in a sale. When two or more companies form a joint venture, it’s for a particular purpose. Once the purpose is served one company can sell the part of its share to another partner.

Your potential would be unlimited; since you would be able to use resources, technologies, staffs to an optimum level, the production capacity and the potential of the venture would be almost unlimited. The only thing that is required is proper due diligence.

DISADVANTAGES OF JOINT VENTURES

As there are many advantages of going into a joint venture, there are also some disadvantages of joint ventures. Let's have a look at these;

Management; given that a joint venture requires the input of each party involved, the management of the joint venture business can often lead to conflicts; or one party may dominate the management of the project/ joint venture and so tensions may arise. There may also be confusion as to who the management consists of; it may be that each party brings in its own management team. However, a new joint venture management team may need to be created. Disagreements will also have to be resolved by senior management.

Differences; ultimately, the parties have the same interests in the joint venture, but their objectives in relations to outcomes may differ leading to conflicts. Joint ventures also require parties to work in close proximity, which may highlight the different working patterns adopted by the respective parties. This can adversely affect the harmony of work relationships amongst the management team and may make the operation of the joint venture lengthy and costly

Competition. There is s possibility when the joint venture comes to an end that one of the parties takes market knowledge from the other party or parties in the joint venture and sets up a business in direct competition. The parties typically protect themselves against this by way of an anti- competition clause in the joint venture contract or agreement.

No equal involvement; it often happens that while running the JV, the involvement of two or more companies Inst as a result, there can be discrepancies and commitment issues.

Cultures are completely different; since two or more companies would come together in a single setting, a clash among cultures can be predicted. As a result, the singular objective may be affected.

Lack of direct communications, in a joint venture, there can be chances of misunderstandings and miscommunication. Since two or more companies come together for a single purpose it's difficult to maintain a direct communication among the employees of the separate companies.

Partnering with another business can be complex. It takes time and effort to build the right relationship.

DIFFERENCES BETWEEN PARTNERSHIP AND JOINT VENTURE ACCOUNTS

Joint venture accounting is similar in nature to a partnership except that the business forms the venture for a specific business transaction, and once that transaction is completed the joint venture ends.
Each party can contribute in different ways to the venture for example, one venture may provide fiancé, another purchase, while the third offers his marketing skills

All or parts of the partner will be involved in handling the business and can also contribute capital.

JOINT VENTURE ACCOUNTING METHODS

These are methods used by a venture in order to recognize its interest in a jointly controlled entity.

Account for joint ventures can he complicated because different methods can be used depending on the circumstances.

The equity method and the proportional consolidation method are two types of accounting methods used when two companies are part of joint venture. Which one is used depends on the way the companies balance sheets and income statements report these partnerships.

THE EQUITY METHOD

The equity method of accounting is used to determine the net income generated from the joint venture partnership in proportion to o the size of a company's investment in the venture. This method of accounting is more commonly used when one company in a joint venture has recognizably greater level of the influence or control over the venture than the other. The equity

method records the share of the joint venture based on the amount actually invested, not the current value of its general ledger accounts. This method is generally preferred because it keeps the partnership book separate from the joint venture. To use equity method;

- Start with the initial investment the partner made in the joint venture

- Add the partner's share of net income or subtract his share of net loss.

- Subtract any dividends paid out to the partner to find his net equity in the joint venture.

THE PROPORTIONAL CONSOLIDATION METHOD

The proportional consolidation method of accounting records the assets and liabilities of a joint venture on a company's balance sheet in proportion to the percentage of participation a company maintains in the venture. In calculating those assets and liabilities, this company lists all income and exercise from the joint venture and includes them on its balance sheet and income statement. Those favoring this method argue that it provides a more accurate and detail record, because it breaks down how well a joint venture performs. It lets each company see the operational effectiveness of various steps in the joint venture process and identify potential steps in the joint venture process and identify potential threats to profitability arising from such things as production costs, shipping costs or profit margin.

DIFFERENCES BETWEEN JOINT VENTURE AND CONSIGNMENT

The following are the differences between joint venture and consignment;

Parties; in joint venture parties to the agreement they are termed as consignor and consignee.

Compensation; corventures are the parties in the venture and share profits or losses of the venture. Whereas consignee is never a partner. Consignee gets his omission for acting as a great for consignor.

Relation; each co-venture is s partner as well as the agent of other co-ventures. Whereas consignee is the agent of his principle i.e cosigner.

Termination, relationship of co-ventures comes to an end when venture is completed. Whereas relationship of consignor and consignee continues until terminated by parties.

Investment- co-ventures, usually, contribute towards the capital of the venture (in the form of money or materials) but consignee does not contribute towards the capital.

Rights: co-ventures enjoy equal rights of their venture but in consignment the consignor is the owner not the consignee.

Account sales; consignee is required to send account sales to consignor. Co-ventures exchange the relevant information. No regular reports are submitted.

JOINT VENTURE JOURNAL ENTRIES

Prepare journal entries in the books of parties doing joint venture business;

There are two methods in which joint venture account can be kept these are;

Where no separate books are kept to record joint venture transactions

Whereas separate set of books is kept to record the transactions.

When separate books are not kept

When it is not possible to maintain a separate set of books for joint venture transactions, each party will use his ordinary business books for recording such transactions. Each party will open venture account and the accounts of other parties in his books. Suppose

A and B enter into a joint venture. Then A will open a joint venture, account and also an account of B in his books similarly, but will open in his books, a joint venture account and the account of A. the following journal entries are made

When goods are purchase and money is spent on joint venture by any partner;

Joint venture account

To cash or seller's account

When goods are purchased by the fellow partners and report is received from them or money is spent by them on

Joint venture

Joint venture account

To partner's personal account.

Thus the venture account in the books of one partner tallies with the same as it stands in the books other partner.

When expenses are incurred by the other party

Joint venture account

To cash account

When expenses are incurred by the other party

Joint venture account

To other party's account

If any advance is received by the other party, say in the form of bill of exchange.

Bills receivables account

To other party' account

If any advance is given to the other party, say in the form of promissory note;

Other party's account

To bills payable account

If the bill receivable is disconnected, the usual entry for discounting the bill is passed. The discount should be transferred to the joint venture account. The entry is joint venture account.

To discount account

If the bill payable was issued in favour of the other party and that party has got it discounted, the discount will have to be debited to the joint venture account, the credit will be in the other party's account.

When the goods bought on the joint venture account are old'

Cash or purchaser's account

To joint venture account

When the goods are sold by the co-partners and on being informed of the sale.

Other party's account

Joint venture

Joint venture account

To partner's personal account.

Thus, the venture account in the books of one partner tallies with the same as it stands in the books of other partner.

When expenses are incurred by the other party

Joint venture account

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When the goods bought on the joint venture account are old'

Cash or purchaser's account

To joint venture account

When the goods are sold by the co-partners and on being informed of the sale.

Other party's account

To joint venture account

When money is received on joint venture

Bank or cash

To joint venture account

If any special commission is received on account of joint venture.

Joint venture account

To commission Account

If any commission is payable to other party

Joint venture account

To other party's account

(Commission may have to be paid for making sales or even for making purchase)

Sometimes some goods are left unsold and one of the parties takes them. The entry is;

Purchase account

To joint venture account

If the goods are taken by the other party

Other party's account

To joint venture account

Now the joint venture account yet will show a profit or loss. The profit will be divided in the agreed proportions. The entry is

Joint venture account

To other parties account

To profit and loss account

(In case of loss the entry will be reversed)

When separate books are kept

Under this method a joint bank account is opened. The amount contributed by each partner as his shares of investment is deposited into a joint bank account, account of the parties concerned are also opened. The system of accounting then is as follows;

The amount contributed by each partner is debited to a joint bank account and credited to the personal account of each partner.

Goods bought on joint venture as well as expenses incurred in connection with the business are debited to the joint venture account and credited to the seller's account or the joint bank account. When the goods are sold, the amount there of is debited to the partner's account or they joint bank account and credited to the joint venture account.

If the parties have taken over plant or materials etc, the value will be debited to the account of the party concerned and credited to the joint venture account.

The joint venture account will now show profit or loss which will be transferred to the personal account of the respective parties in their profit sharing ratio.

The joint bank account will then be closed by making payment to each partner of what is due to him in respect of his personal account.

Joint venture accounts

Debit	Anything the ventures put into the enterprise (e.g cash, purchases. expenses paid etc)
Credit	Anything the ventures takeout of the enterprise (e.g sales and cash withdrawal, assets withdrawal etc

The journal entries will be the above

TRANSACTION POSTINGS

Both business will record their own transactions in their accounting records, in each case the side of the durable entry book keeping posting will go to a joint venture control account.

Debit Anything the ventures put into the enterprise (e.g cash, purchases. expenses paid etc)

Credit Anything the ventures takeout of the enterprise (e.g sales and cash withdrawal, assets withdrawal etc

To reflect its transactions, business a makes the following postings;

Business A- joint venture accounting journal entry

Account	Debit	Credit
Purchases		3,200
Wages		4,000
Joint venture account (business B)	7,200	
Total	**7,200**	**7,200**

The effect of the entries is to transfer the expenses relating to the materials and the wages to the joint venture control account.

Likewise business B makes the following postings to reflect its own transactions.

Business B- joint venture accounting journal entry.

Account	Debit	Credit
Selling expenses		2,400
wages		5,000

Revenue	26,000	
Joint Venture Account (business A)		1 8,600
Total	**26,000**	**26,000**

Again the effect of the joint venture accounting is to transfer the expenses incurred and the revenue to the joint venture control account.

Memorandum of joint venture account / income statement

The memorandum joint venture account is not a double entry account. It is drawn up only to find out;

a) The shares of the net profit or loss and

b) To help calculate the amounts payable and receivable to close joint venture.

This is another method to record the transactions in the books of the various parties. Under this method the joint venture account is prepared on memorandum basis, just to find out the profit or loss but not as a part of financial books.

Format of memorandum joint venture account

Purchases at Total -purchases by P&Q	x	Sales account —total Receipt by P&Q	X
Expenses account- Total expenses by P&Q	x	Debtors – credit Sales by P&Q	X
Commission received by P&Q profit and loss	X	Assets taken over by P&Q	X
P's profit	X	Assets account	-x
Q's	X	Steak withdraw	X
	xx		xx

Example 1:

Filza pvt ltd and DYN PvT Ltd are suppliers of instant reasoning in Selangor. Both companies have agreed to undertake a joint venture to introduce new product. Filza will supply the product and bear any expenses incurred. DYN will sell the product ad receive cash, and also cover any relevant expenses. Profit and losses were to be shared equally. The followings are the relevant information regarding the transactions occurred.

Workings;

Step 1:

Filza and a DYN will prepare their own joint venture account respectively. Filza will open the "joint venture Account with a DYN" and vice versa. The double entry for this transaction was as follows;

In the book of Filza PvT Ltd payment Debit

Joint venture account with DYN

Credit cash account

Purchase debit

Joint venture account with DYN

Credit purchases

In the book of DYN Ps ltd payment Debit

Joint venture account with Filza

Credit cash account

Receipt Debit

Cash Account

Credit venture account with Filza

In the book of a Filza Rvt ltd

Joint venture with Filtza Account

	RM		RM
Cash carriage	120		
Cash: selling expenses	320	Cash: Sales	3200

Joint venture with Filtza Account

	RM		RM
Cash carriage	120		
Cash: Selling Expenses	320	cash: sales	3200

Joint venture with DYN Account

	RM		RM
Purchases	1800		
Cash: wages	200		
Cash: storage cost	160		

Step 2

The memorandum joint venture account is prepared in order to determine whether the company gains profit or suffer a loss. The distribution of profit or loss is made based on

MEMORANDUM JOINT VENTURE ACCOUNT

	RM	RM		RM
Purchases		1800	Sales	3200
Wages		200		
Storage expenses		160		
Carriage expenses		120		
Expenses "selling		320		
Profit:				
Filza (1/2)	300			
DYN (1/2)	300	600		
		3200		3200

the agreed ratio which is to be shared equally. The details in the memorandum are the combination of very Joint Venture Account.

Step 3:

The profit obtained by Filza and DYN will be distributed in their accounts

Filza's book account with DYN — Profit debit Joint venture credit P&L

DYN'S book account with a Filza — Profit debit joint venture credit P&L

In the book of Filza pvT Ltd

Joint venture with DYN Account

	RM		RM
Purchases	1800	Balance c/d	2460
Cash wages	200		
Cash storage cost	160		
P&L	300		
	2460		2460
Balance b/d	2460	Cash from DYN	2460

IN THE BOOK OF DYN PV LTD

Joint Venture with Filza Account

	RM		RM
Cash: carriage	120	Cash sales	3200
Cash: selling expenses	320		
P&L	300		
Balance c/d	2460		
	3200		3200
Cash paid to filza	2460	Balance b/d	2460

Example 2:

Memorandum joint venture account

Debit side			Credit Side	
		$		$
To A (cost of goods and expe)		5,400	By sales	12,000
To b (cost of goods and expt)		4,300		
To b (commission)		600		
To profit:				
A $^{4}/_{5}$	1,360			
B $^{1}/_{5}$	340	1,700		
		12,000		12,000

IN THE BOOKS OF A

Joint Venture with B Account

IN THE BOOKS OF B

Joint Venture with A Account

Debit side	$	Credit Side	$
To cash (goods)	4,000	By cash	12,000
To cash (expenses)	300		
To commission	600		
To profit and loss (1/0 of profit)	340		
To cash	6,760		
	12,000		12,000

JOINT VENTURE PROFIT SHARE

Each business will now take their share of the joint venture profits into their own accounts with the following entries;

Debit side	$	Credit Side	$
To cash (goods)	5,400	By cash	6,760
To cash (expenses)	4,300		
To profit and loss (4/50 of profit	1,360		
	6,760		6,760

Business a –shares of profit journal entry

Account	Debit	Credit
Joint venture (Business B)	6,840	
Joint venture profit share		6,840
Total	**6,840**	**6,840**

Business B- Share of Profit Journal Entry

Account	Debit	Credit
Joint venture (Business A)	4,560	
Joint venture profit share		4,560
Total	**4,560**	**4,560**

Tutor marked assignment- study unit 3

a) Identify the salient features of joint ventures.
b) Salim & Sons bought goods of the value of shs.7,500 and consigned them to Tahir and Co. to be sold to them on a joint venture, profit being divided in 2/3: 1/3. They also paid shs.550 for freight, insurance and cartage and drew on Tahir and Co. for shs.3,000 on account. The bill was discounted by Salim & Sons for shs.2,900. Tahir and Co. paid shs.300 for dock dues, storage, rent etc. The sales realised shs.12,500 and the sales expenses shs.250 were defrayed by Tahir and Co. The later forwarded a sight draft for the balance due to Salim & Sons after charging their sales commission at 5 percent on the gross proceeds.

Required: Write up the accounts in the books of both the parties. No interest need to be brought into account.