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Proposed Accounting Standards Update, *Business Combinations – Joint Venture Formations (Subtopic 805-60)* (File Reference No. 2022-ED300)

Dear Ms. Salo:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Business Combinations – Joint Venture Formations (Subtopic 805-60)* (Update), issued by the Financial Accounting Standards Board (Board).

We support the Board's proposal to require a joint venture to apply a new basis of accounting and initially measure most of its assets and liabilities at fair value upon formation. We believe this would reduce diversity in practice related to the measurement of joint ventures at formation. While we believe the proposed amendments generally would be understandable and operable, we recommend that the Board clarify certain aspects.

Appendix A contains our responses to the questions in the proposal and our recommendations. Appendix B includes additional suggested clarifications to the proposal.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Appendix A – Responses to questions in the Proposed Accounting Standards Update, *Business Combinations – Joint Venture Formations (Subtopic 805-60)*

Question 1: Do you agree with the Board's decision to require that a joint venture recognize and initially measure its assets and liabilities upon formation in accordance with the amendments in this proposed Update (at fair value with exceptions that are consistent with the business combinations guidance)? Alternatively, should the Board require or permit a joint venture to recognize and initially measure its assets and liabilities upon formation at venturers' carrying amounts? Please explain your response.

Question 2: Would the requirement that a joint venture recognize and initially measure its assets and liabilities upon formation in accordance with the proposed amendments (at fair value with exceptions that are consistent with the business combinations guidance) result in more decision-useful information for users of a joint venture's financial statements? If so, how would that information influence investment and capital allocation decisions?

Question 3: Would the proposed amendments impose significant incremental costs? Please describe the nature and magnitude of costs, differentiating between one-time costs and recurring costs.

Question 4: The Board expects that the proposed amendments would align more closely the accounting required for the joint venture and the venturers and thus eliminate or reduce differences in the basis for the joint venture's financial statements when compared with the reported investment by the venturers.

Venturer accounting is not within the scope of this project, but the requirement for venturers to account for basis differences does factor into the costs and benefits of providing initial measurement guidance for joint ventures. Upon a joint venture's formation, do you expect that significant differences in the basis of the joint venture's financial statements will exist when compared with the reported investment by the venturers under the proposed amendments? If you expect that significant basis differences would remain, please describe the circumstances that would give rise to those differences.

Question 5: Do you foresee any operability or auditing concerns in recognizing and initially measuring a joint venture's assets and liabilities upon formation in accordance with the proposed amendments (at fair value with certain exceptions that are consistent with the business combinations guidance)? Please describe the nature of any operability or auditing concerns.

We believe that requiring a joint venture to recognize and initially measure its assets and liabilities in a manner generally consistent with Accounting Standards Codification (ASC) 805, *Business Combinations*, would be operable. We believe that recognizing a joint venture at the fair value of its equity instruments (inclusive of goodwill created at formation) would result in significantly fewer basis differences than one of the current approaches in practice of valuing assets contributed by investors at the carrying amount. We believe that certain joint ventures already apply an approach using fair value measurement principles.

In addition, we note that the Board has received feedback from preparers who say that recognizing their net assets at fair value would be more relevant than measuring their net assets at the investors' carrying amounts at the formation date and would reduce equity method basis differences for the investors.

We recommend that the Board consider making clarifications in the following areas of the proposed amendments.

Contingent payments

We believe the Board should clarify how to account for transactions that may include contingent payments to the contributing investors. In a business combination, such arrangements are negotiated as part of the terms of the business combination and accounted for as contingent consideration unless they represent a transaction separate from the business combination. Although the proposed amendments don't explicitly address this, the discussion in paragraphs BC52-BC57 (of the Background Information and Basis for Conclusions section) indicates that the Board intends for contingent payments to the contributing investors be accounted for consistent with the guidance on pre-acquisition contingencies in ASC 805-20, *Business Combinations – Identifiable Assets and Liabilities, and Any Noncontrolling Interest*. We believe it would be helpful for the Board to explicitly state this in the final guidance. Otherwise, we believe there could be confusion about initial recognition and measurement and subsequent measurement, since these arrangements may have characteristics similar to those that represent contingent consideration in a business combination.

Transfer of financial assets

As stated in paragraph 805-60-25-15 (and as further explained in paragraph BC65), a joint venture would apply ASC 860-10, *Transfers and Servicing – Overall*, to determine whether the transfer of financial assets in the scope of ASC 860-10 results in the recognition of transferred financial assets by the joint venture. To properly comment on the proposal, we would need more clarity on why the joint venture would perform the analysis under the guidance in ASC 860-10 and what effect this would have on the joint venture's financial statements.

Question 6: The proposed amendments describe and define the formation date as the date on which an entity initially meets the definition of a joint venture. Is the proposed guidance on a joint venture's formation date understandable and operable? Please explain your response.

Question 7: The proposed definition of the formation date varies from the definition of the acquisition date in Subtopic 805-10, which is the date on which the acquirer obtains control of the acquiree. During initial deliberations, the Board considered whether the definition should similarly specify that the formation date occurs when the joint venture has control of the assets necessary to begin operating in accordance with its purpose (and initially meets the definition of a joint venture). Would this additional clarification result in a more relevant measurement date as compared with the proposed definition? Please explain your response, including any relevant considerations relating to the date that a venturer is required to initially measure its interest in the joint venture in accordance with Subtopic 610-20, *Other Income–Gains and Losses from the Derecognition of Nonfinancial Assets*, and Subtopic 810-10, *Consolidation–Overall*, and whether the additional clarification would result in a different conclusion than the proposed definition.

We support defining the formation date as the date on which the entity initially meets the definition of a joint venture because we believe this definition would be understandable and operable. We believe that in most cases the formation date under this definition is clear and represents the date that the investors have contributed net assets to the joint venture in exchange for their equity interest in the entity. We recommend that the Board not include the phrase “when the joint venture has control of the assets necessary to begin operations in accordance with its purpose” in the definition because it may be challenging to interpret this phrase without additional interpretative guidance, in particular when a joint venture is in a development phase or there is a lag in the contribution of assets.

Question 8: Do you agree with the proposal that a joint venture, upon formation, would recognize the fair value of the joint venture as a whole in excess of the amount recognized for its identifiable net assets as goodwill, regardless of whether the net assets controlled by the joint venture upon formation meet the definition of a business? If not recognized as goodwill, how should the excess be accounted for? Please explain your response.

We recommend that the guidance say a joint venture, upon formation, recognizes the fair value of the joint venture as a whole in excess of the amount recognized for its identifiable net assets as goodwill only if the joint venture is a business as defined by ASC 805. If a joint venture does not meet the definition of a business, we recommend that it not recognize goodwill. We are not aware of any instances that result in the recognition of goodwill for entities other than businesses. The existing framework for the initial recognition and subsequent measurement of goodwill is based on goodwill being associated only with businesses. Therefore, we believe the subsequent measurement guidance in ASC 350, *Intangibles – Goodwill and Other*, would be difficult to apply to entities other than businesses without further amendment.

If the joint venture does not meet the definition of a business, we believe the excess fair value of the joint venture as a whole over the amount recognized for its identifiable net assets should be recognized as an adjustment to equity. This accounting would be consistent with the proposed accounting for negative goodwill as stated in paragraph 805-60-30-3.

Question 9: Do you agree with the proposed amendments that joint ventures, upon formation, should capitalize intangible research and development assets (regardless of whether they have an alternative future use) and subsequently test those assets as indefinite lived for impairment until the completion or abandonment of the associated research and development efforts? Please explain your response.

We agree with the proposed amendments because they would align the joint venture’s accounting with that for business combinations.

Question 10: The proposed amendments would prohibit a joint venture from making measurement period adjustments in the same manner as the acquirer of a business. In accordance with Topic 805, the acquirer of a business can adjust provisional amounts recognized if the initial accounting for a business combination is incomplete by the end of the reporting period in which the business combination occurs. Would it be necessary for a joint venture to be permitted to make measurement period adjustments after formation? Please explain your response.

We recommend that the Board consider permitting joint ventures to use a measurement period. In paragraphs BC63 and BC64, the Board explains that joint ventures generally would have sufficient information available to recognize and measure their net assets upon formation without the use of a measurement period and that a measurement period would be unnecessary and introduce an additional layer of complexity.

Based on discussions with our valuation practice, we understand that there may be certain challenges associated with identifying and measuring individual intangible assets as of the formation date. That is, while the fair value of each investor's interest in the joint venture is determined at the formation date, the joint venture itself may not have completed its efforts to identify and measure all of its individual assets.

We also believe that allowing joint ventures to use a measurement period would be consistent with the application of the principles of ASC 805 to the formation of the joint venture, and we don't believe this would introduce additional burden or complexity in the joint venture formation accounting.

Question 11: Do you foresee any operability or auditing concerns in applying the proposed amendments for determining which transactions are part of the formation of a joint venture? Please describe any operability or auditing concerns.

We believe the proposed amendments in paragraph 805-60-25-6 related to determining which transactions are part of the formation of a joint venture should include a principle similar to ASC 805-10-25-20 and 25-21. To further align the proposed amendments with the accounting for business combinations, we suggest adding the following:

805-60-25-6: A joint venture and its owners (the venturers) may enter into an arrangement upon formation that is separate from the formation of the joint venture. The joint venture shall identify any amounts that are not part of the joint venture formation and shall recognize only the identifiable assets and liabilities that are determined to be part of the joint venture formation. A transaction entered into by or on behalf of the joint venture, rather than primarily for the benefit of the venturers is likely to be a separate transaction. Separate transactions shall be accounted for in accordance with the relevant generally accepted accounting principles. See paragraph 805-10-55-18.

Question 12: Is there a need for the Board to reconsider or eliminate the definition (and related scope exceptions) of a joint venture? If so, please explain your response, including how the joint venture definition (and related scope exceptions) should be changed, and the relative priority of such a consideration.

Although there may be challenges in applying the definition of a joint venture, we recommend that the Board not reconsider or eliminate the definition, which would be beyond the scope of the current project. We believe the proposal would be operable without revisiting the definition.

However, we suggest that the Board clarify the scope exception for entities that may be proportionately consolidated by one or more of the venturers. As currently written, the proposed scope exception could be interpreted to apply to joint ventures with investors in certain specialized industries (such as the extractive and construction industries) where investors are able to account for their interests through proportionate consolidation. If the Board's intent is to only exclude joint ventures that have one or more investors that account for their interests in the joint venture using proportionate consolidation, we believe the Board's intent should be clearly stated. If this is the Board's intent, there could be challenges in applying the scope exception since the joint venture's accounting is dependent on the investor's accounting policy.

We also recommend that the Board remove the scope exception for collaborative arrangements that are in the scope of ASC 808, *Collaborative Arrangements*. Given that a joint venture is organized as a separate legal entity and would not represent a collaborative arrangement, it is unclear what is intended by the scope exception. In addition, some could interpret the inclusion of the scope exception to mean that the proposal wouldn't apply to joint venture formation transactions in which the joint venture is a party to a collaborative arrangement with each of its investors. This could lead to diversity in practice in the application of the scope exception.

Question 13: Do you agree with the transition guidance in this proposed Update? Please explain your response.

Question 14: How much time would be needed to implement the proposed amendments? Is the amount of time needed to implement the proposed amendments by entities other than public business entities different from the amount of time needed by public business entities? Should early adoption be permitted? Please explain your response.

We agree that the proposed amendments should be applied on a prospective basis to joint venture formations that occur on or after the effective date, consistent with the transition guidance in other business combination-related standards. We also believe that early adoption should be permitted.

We recommend that the Board remove the retrospective option from the proposed transition guidance because we believe it could introduce hindsight in the determination of fair value with respect to a previous joint venture formation transaction and could require additional guidance to implement.

Appendix B – Other comments

We recommend making the following clarifications to the proposal:

- 1) Adding references to joint venture formations in paragraphs 205-10-05-3, 205-10-15-2, 205-20-45-1D and 205-20-55-82, since this guidance may also apply to them:

205-10-05-3: The Discontinued Operations Subtopic discusses the conditions under which either of the following would be reported in an entity's financial statements as a discontinued operation:

- a. A component of an entity that either has been disposed of or is classified as held for sale
- b. A business or nonprofit activity that, on acquisition or upon formation of a joint venture or corporate joint venture, is classified as held for sale.

205-20-15-2: The guidance in this Subtopic applies to either of the following:

- a. A component of an entity or a group of components of an entity that is disposed of or is classified as held for sale
- b. A business or nonprofit activity that, on acquisition or upon formation of a joint venture or corporate joint venture, is classified as held for sale.

205-20-45-1D: A business or nonprofit activity that, on acquisition or upon formation of a joint venture or corporate joint venture, meets the criteria in paragraph 205-20-45-1E to be classified as held for sale is a discontinued operation. If the one-year requirement in paragraph 205-20-45-1E(d) is met (except as permitted by paragraph 205-20-45-1G), a business or nonprofit activity shall be classified as held for sale as a discontinued operation at the acquisition date or formation date if the other criteria in paragraph 205-20-45-1E are probable of being met within a short period following the acquisition or formation date (usually within three months).

205-20-55-82: Disclosures are complete for a discontinued operation that is a business or a nonprofit activity held for sale at acquisition or upon formation of a joint venture or a corporate joint venture.

- 2) Amending the proposed paragraph 718-10-15-8 that would address the scoping of share-based payment awards to include wording similar to that in paragraph 718-10-15-6 on the scoping of share-based payment awards issued in a business combination, as follows:

Paragraph 805-60-25-8 provides guidance on determining whether share-based payment awards issued by a joint venture entity upon formation is part of the joint venture formation transaction and, therefore, in the scope of Topic 805-60, or are for continued service to be recognized in the post-formation period in accordance with this Topic.

- 3) Adding references to joint venture formations in paragraph 740-10-05-8:

As indicated in paragraph 740-10-25-23, temporary differences that will result in taxable amounts in future years when the related asset or liability is recovered or settled are often referred to as taxable temporary differences. Likewise, temporary differences that will result in deductible amounts in future years are often referred to as deductible temporary differences. Business combinations and joint venture formations may give rise to both taxable and deductible temporary differences.

- 4) Adding a reference to a corporate joint venture in paragraph 740-10-30-4, since ASC 740 does not collectively refer to joint ventures and corporate joint ventures as joint ventures:

Deferred tax expense (or benefit) is the change during the year in an entity's deferred tax liabilities and assets. For deferred tax liabilities and assets recognized in a business combination or in an acquisition by a not-for-profit entity during the year, it is the change since the acquisition date. For deferred tax liabilities and assets recognized by a joint venture or a corporate joint venture upon formation, during the year that includes the formation date, it is the change since the formation date. Paragraph 830-740-45-1 addresses the manner of reporting the transaction gain or loss that is included in the net change in a deferred foreign tax liability or asset when the reporting currency is the functional currency.

- 5) Adding a reference to joint venture formation in the income tax accounting for business combinations in paragraph 805-20-25-21:

Section 805-740-25 establishes the recognition guidance for accounting for income taxes in a business combination or a joint venture upon formation.

- 6) Updating paragraph 805-60-30-7 to be consistent with paragraph 805-60-30-5:

A joint venture shall initially measure liability-classified replacement share-based payment awards at the fair-value-based measurement method described in Topic 718 (consistent with the requirements in paragraph 805-60-30-1). The fair-value-based amount of any replacement share-based payments classified as a liability (the amount allocated to pre-formation vesting in accordance with paragraph 805-60-25-8) shall be recognized as a reallocation of additional paid-in capital (or other similar equity account, such as members' equity) and shall not affect the total amount of goodwill recognized by the joint venture upon formation.

- 7) Adding a reference to the guidance on joint venture formations to paragraph 808-10-15-4 (as mentioned previously, we believe the scope exception related to collaborative arrangements should be removed from any final guidance):

A collaborative arrangement within the scope of this Topic is not primarily conducted through a separate legal entity created for that activity. However, in some situations part of a collaborative arrangement may be conducted in a legal entity for specific activities or for a specific geographic location. The existence of a legal entity for part of an arrangement does not prevent an arrangement from being a collaborative arrangement. The part of the

arrangement that is conducted in a separate legal entity shall be accounted for under the guidance in Topic 810, Consolidation, Subtopic 323-10, Investments–Equity Method and Joint Ventures, Subtopic 805-60, Business combinations–Joint Venture Formations or other related accounting literature. However, the disclosures required by paragraph 808-10-50-1 apply to the entire collaborative arrangement, notwithstanding that a portion of the collaborative arrangement may be conducted in a legal entity.

- 8) Updating paragraph 815-10-15-74 (c)(4) to state the following:

~~In a joint venture's separate financial statements, A contract between a joint venture and its venturers to form a joint venture accounted for in accordance with Subtopic 805-60.~~

- 9) Adding a reference to joint venture formations in the leverage lease scope exception paragraph 842-50-15-1 rather than the proposed amendments to 842-50-25-2, 842-50-30-2 and 842-50-35-1:

This Subtopic addresses accounting for leases that meet the criteria in transition paragraph 842-10-65-1(z). If a lessee exercises an option to extend a lease that meets the criteria in transition paragraph 842-10-65-1(z) that it was not previously reasonably assured of exercising, the exercise of that option shall be considered a lease modification as described in paragraph 842-10-65-1(z). A joint venture formation accounted for in accordance with Subtopic 805-60 shall apply the guidance in this Subtopic applicable to the acquiring entity in a business combination. The joint venture shall be viewed as analogous to the acquiring entity in a business combination, and any recognized businesses and/or assets shall be viewed as analogous to an acquired entity.