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Technical Line

FASB — final guidance

A closer look at the FASB's guidance on accounting for joint venture formations

In this issue:

Overview 1
Key considerations 2
Scope and key terms 2
Accounting by a joint venture upon its formation 4
Initial measurement 4
Subsequent measurement 9
Disclosure 10
Transition and effective date 10

What you need to know

- Certain joint ventures are required to apply a new basis of accounting upon formation by recognizing and initially measuring most of their assets and liabilities at fair value under the new guidance issued by the FASB.
- The guidance applies to joint ventures that meet the definition in ASC 323, except those that may be proportionately consolidated by one or more investors and those that are not-for-profit entities or collaborative arrangements in the scope of ASC 808 not conducted in a separate legal entity.
- The guidance does not amend the definition of a joint venture or change the accounting by the investors in a joint venture.
- The guidance is effective for all joint venture formations with a formation date on or after 1 January 2025. Early adoption is permitted. Joint ventures formed before the effective date have the option to apply it retrospectively, while those formed after the effective date are required to apply it prospectively.

Overview

The **Accounting Standards Update**[1] **(ASU)** issued by the Financial Accounting Standards Board (FASB or Board) requires certain joint ventures, upon formation, to apply a new basis of accounting and initially measure most of their assets and liabilities at fair value in their financial statements.

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The guidance is intended to address diversity in practice. Because US GAAP did not address how a joint venture should recognize and initially measure contributed assets and assumed liabilities upon its formation, some joint ventures initially measured their assets at fair value, while others accounted for their net assets at the investors' carrying amounts.

The ASU does not change the definition of a joint venture, the accounting by the investors for their investments in a joint venture (e.g., equity method accounting) or the accounting by a joint venture for contributions received after its formation.

Key considerations

The guidance affects the accounting for contributions received upon formation by entities that meet the definition of a joint venture as defined by US GAAP, with certain scope exceptions. Once the joint venture determines that it is subject to the guidance, it must identify its formation date, which is the date that the joint venture uses to initially measure its net assets in its separate financial statements, similar to the acquisition date in a business combination.

Scope and key terms

The guidance applies to the formation of joint ventures as defined in Accounting Standards Codification (ASC) 323,[2] except for those that may be proportionately consolidated by one or more investors and those that are not-for-profit entities or collaborative arrangements in the scope of ASC 808[3] that are not conducted in a separate legal entity. The Board clarified that the proportionate consolidation exception is intended to exclude joint ventures where investors can (but don't necessarily) account for their interests through proportionate consolidation.[4] Proportionate consolidation is permitted only for unconsolidated investments in unincorporated legal entities (e.g., partnerships) in the extractive or construction industries. If an entity does not meet the definition of a joint venture or meets one of the scope exceptions listed above, it would apply other GAAP rather than the guidance in ASC 805-60.

The final standard applies to a joint venture's financial statements and does not affect the accounting by the investors.

Definition of a joint venture

The ASU does not change the definition of a joint venture as stated in ASC 323, which describes characteristics generally present in joint ventures.[5] Based on that definition, we believe a joint venture is required to have all of the following characteristics:

- The arrangement is organized within a separate legal entity.
- The entity is under the joint control of its investors.
- The investors are able to exercise joint control of the entity through their equity investments.
- The entity's purpose, design and other characteristics are consistent with the definition of a joint venture.

The Securities and Exchange Commission (SEC) staff has said that each of the characteristics in the ASC 323 definition should be met for an entity to be considered a joint venture. The staff also has said it would object to a conclusion that joint control is the only defining characteristic of a joint venture.[6]

How we see it

Although the term joint venture is often used loosely in practice to describe many types of arrangements and may appear in legal documents and public statements by management, we believe the definition of a joint venture in US GAAP is fairly narrow. An entity that is similar to a joint venture but does not meet the definition of a joint venture would not apply the guidance. Rather, the formation transaction may need to be accounted for as a business combination under ASC 805.

Formation date

Under the guidance, a joint venture determines its formation date and measures the net assets contributed as part of the formation transaction as of that date. The formation date is the date on which an entity initially meets the definition of a joint venture, which is not necessarily the inception date of the legal entity. If multiple arrangements are accounted for as a single transaction that establishes the formation of a joint venture, the formation date is the measurement date for all arrangements that form the joint venture.

Determining whether multiple arrangements should be accounted for as a single formation transaction

A joint venture formation may be established through multiple arrangements. Determining whether multiple arrangements represent a single transaction for accounting purposes depends on the facts and circumstances and requires the use of professional judgement.

The following factors listed in ASC 805-60-25-4 may be considered to determine whether the multiple transactions should be accounted for as a single transaction that established the formation of the joint venture:

- The multiple arrangements are entered into at the same time or in contemplation of one another.
- The multiple arrangements form a single transaction designed to achieve an overall commercial effect.
- The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
- One arrangement considered on its own is not economically justified, but the multiple arrangements are economically justified when considered together.

If multiple arrangements are accounted for as a single transaction, then the formation date should be the measurement date for all arrangements that form part of the single formation transaction. All contributions received, or that are receivable, as of the formation date, including consideration of the guidance to determine whether multiple arrangements represent a single transaction, form part of the joint venture formation transaction. However, if net assets are contributed subsequent to the formation date but form part of the formation transaction, the joint venture recognizes the contributed identifiable assets and liabilities only when they satisfy the recognition criteria in ASC 805-60.

Determining what is part of the joint venture formation

A joint venture and its investors may enter into an arrangement that is separate from the formation of a joint venture. For example, a joint venture may enter into an arrangement with an investor to compensate the investor or its employees for future services.

Because the identification of these arrangements often requires judgment, the FASB stated that a joint venture applies the guidance in paragraphs 805-10-55-24 through 55-26 when determining whether a transaction involving payments to be made by the joint venture to the investors or others is separate from or part of a joint venture formation.

Paragraph 805-10-55-24 states that determining whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

A joint venture recognizes the identifiable asset and liabilities that are determined to be part of the joint venture formation. Arrangements that are separate from the formation transaction should be accounted for in accordance with other GAAP.

Accounting by a joint venture upon its formation

Initial measurement

The guidance requires a newly formed joint venture to apply a new basis of accounting upon formation in its standalone financial statements and measure its total net assets upon formation at the fair value of the joint venture as a whole, which would equal the fair value of 100% of the joint venture's outstanding equity interests. Upon formation, a joint venture generally recognizes and initially measures its identifiable assets and liabilities at fair value, generally consistent with the acquisition method for business combinations.

The guidance in ASC 323 requires an investor that contributes a business or nonfinancial assets in exchange for an equity interest in a joint venture to recognize the equity investment at fair value in accordance with ASC 810[7] or ASC 610-20,[8] respectively. Accordingly, the Board decided that one of the benefits of requiring a new basis of accounting (i.e., fair value accounting) for the joint venture upon formation is that it would reduce equity method basis differences for the investors. In addition, the Board believes that the joint venture is able to leverage the investors' measurements to reduce the overall costs of applying fair value at formation.[9]

Goodwill is recognized as the excess of fair value of the joint venture as a whole over the fair value of the identifiable net assets recognized by the joint venture.

The sections below discuss certain nuances between the joint venture formation guidance and the acquisition method for business combinations.

How we see it

The final guidance requires that a joint venture measure its net assets upon formation using the fair value of the joint venture as a whole, which is 100% of the joint venture's equity immediately after formation. Under this guidance, the fair value measurement would include expected synergies, including any synergies among the businesses contributed by the investors. Since an investor that contributes a business in exchange for an equity interest in a joint venture recognizes the investment at fair value in accordance with ASC 810, we would not expect equity method basis differences to arise between the investor and investee related to synergies from the contributed businesses.

Goodwill

Goodwill is an asset representing the future economic benefits arising from other assets recognized by a joint venture upon formation that are not individually identified and separately recognized. In accounting for its formation, a joint venture will measure goodwill as the excess of the fair value of the joint venture's outstanding equity interests over the fair value of its identifiable assets and liabilities.

For joint venture formations, goodwill is recognized regardless of whether the joint venture meets the definition of a business. The Board expects that it will be unusual that an entity simultaneously meets the definition of a joint venture, has an equity interest fair value that more than insignificantly exceeds that of its identifiable net assets fair value and is not a business. Before a joint venture recognizes goodwill, the Board expects the joint venture to make sure it has correctly identified all of the contributed identifiable net assets and that all available information as of the formation date has been considered when measuring those identifiable net assets and the joint venture as a whole.[10]

Illustration 1 – A joint venture's accounting for goodwill at its formation date

Company A and Company B form Joint Venture C, which meets the definition of a joint venture under ASC 323 and is a for-profit entity. Upon the joint venture's formation, Company A contributes a business that manufactures automotive parts, and Company B contributes a business that distributes automotive parts. Company A and Company B both receive equity in Joint Venture C in exchange for their contributions and apply the equity method to account for their investments in the joint venture.

Under the new guidance, Joint Venture C determines the fair value of the joint venture as a whole by estimating the fair value of 100% of its equity immediately after formation. Joint Venture C then separately measures the identifiable assets and liabilities, including any identifiable intangible assets, consistent with the acquisition method for business combinations.

Joint Venture C determines that the fair value of 100% of its equity is $200, and the fair value of its identifiable net assets is $180. Therefore, Joint Venture C recognizes $20 of goodwill to reflect the difference between the fair value of the joint venture as a whole and the fair value of the identifiable net assets.

In-process research and development (IPR&D)

In accounting for its formation, a joint venture will capitalize contributed tangible and intangible research and development assets regardless of whether the joint venture meets the definition of a business. This requirement applies regardless of whether those assets have an alternative future use. The requirement to capitalize IPR&D assets is consistent with the acquisition method for business combinations, which serves as the underlying principle when recognizing and initially measuring the net assets contributed upon a joint venture formation.

See section 4.2.6 of our Financial reporting developments (FRD) publication, ***Business combinations***, for further discussion on IPR&D assets.

Contingent consideration

Joint venture formations may involve contingent payment arrangements, which include a promise to make payments or issue equity interests to an investor contingent upon the performance of the assets or businesses contributed by the investor.

For liability-classified (or asset-classified) contingencies, the instrument is recognized consistent with assets and liabilities arising from contingencies (i.e., preacquisition contingencies) under ASC 805.[11] Thus, the instrument is recognized at fair value, in accordance with the guidance in ASC 820,[12] if the fair value can be determined during the measurement period.

If the fair value of the contingency cannot be determined during the measurement period, the guidance requires that the contingency be recognized at the formation date in accordance with ASC 450,[13] if it meets the criteria for recognition under that guidance. If these recognition criteria are not met using the information available during the measurement period, the joint venture does not recognize an asset or liability as of the formation date.

See section 4.4.1 of our FRD, ***Business combinations***, for further discussion on preacquisition contingencies.

For equity-classified contingencies, the instrument is accounted for as a reallocation of additional paid-in capital or other similar equity account, such as member's equity. We believe the equity-classified contingencies are initially measured at fair value with no subsequent remeasurement, and their subsequent settlement is accounted for within equity, consistent

with the accounting for equity-classified contingent consideration in a business combination. Accordingly, the equity-classified arrangement will not affect the total amount of equity or goodwill recognized by the joint venture upon formation.

How we see it

The joint venture's total net assets (including goodwill) are measured using the fair value of the joint venture as a whole upon formation instead of the "consideration transferred" model for business combinations under ASC 805. The FASB observed that it may be challenging to identify contingent consideration arrangements as they are defined in Subtopic 805-30 for a joint venture formation. Thus, liability-classified (or asset-classified) contingencies in a joint venture formation are accounted for as preacquisition contingencies under ASC 805, which may result in some arrangements that are (a) not initially measured at fair value or (b) not subsequently measured at fair value with gains or losses recognized in earnings. This differs from the contingent consideration guidance in Subtopic 805-30, which requires initial and subsequent measurement at fair value.

Transfer of financial assets

A joint venture formation may include a transfer of financial assets. When an investor transfers financial assets that are in the scope of ASC 860-10[14] to a joint venture upon formation, the joint venture is required to determine whether the transfer results in the recognition of transferred financial assets by applying the guidance in ASC 860-10. This requirement is intended to improve alignment between the investors that account for transfers of financial assets in accordance with ASC 860 and a joint venture that is the recipient of a transfer of financial assets. When there is a transfer of financial assets, the financial assets are recognized and initially measured at fair value consistent with the acquisition method for business combinations.

Replacement share-based awards

If, upon formation, a joint venture issues share-based payment awards to replace awards held by grantees of the contributed entities, the liability or equity instrument issued to replace the previously held awards is measured in accordance with the fair-value-based measurement provisions of ASC 718.[15] The joint venture then allocates the fair-value-based measure of the replacement share-based payment awards between the preformation vesting and post-formation compensation cost.

The following illustration consists of examples excerpted from ASC 805-60-55-2 through 55-14:

Illustration 2 – Joint venture replacement share-based payment awards

On January 1, 20X0, a newly formed corporation with no assets or liabilities, New Venture, receives contributions of a controlling financial interest in Business A (90 percent voting interest) from Venturer 1 and Business B (100 percent voting interest) from Venturer 2 and, in exchange, issues 50 common shares to each Venturer 1 and Venturer 2. Assume that New Venture has no other classes of equity or any other equity instruments outstanding before receiving the contributions. It is determined that New Venture first met the definition of a joint venture on January 1, 20X0. New Venture determines January 1, 20X0, to be its formation date.

In accordance with paragraph 805-60-30-2, but before consideration of any liabilities for share-based payments, New Venture determines that the fair value of the joint venture as a whole is $100 million including a noncontrolling interest (10 percent voting interest) in Business A that is owned by an outside entity. It also determines, in accordance with paragraph 805-60-30-2, that the formation-date fair value of the identifiable assets is $120 million, the fair value of the liabilities is $40 million, and the fair value of the noncontrolling interest in Business A is $5 million.

Upon formation, New Venture exchanges replacement awards that require one year of postformation vesting for share-based payment awards of Business A for which employees had not yet rendered all of the required services as of the formation date. The fair-value-based measure of both awards (the original awards and the replacement awards) is $20 million at the formation date. When originally granted, the awards of the contributed business had a requisite service period of four years. As of the formation date, the contributed business's employees had rendered two years' service, and they would have been required to render two additional years of service after the formation date for their awards to vest. Accordingly, only a portion of the contributed business's awards is attributable to preformation vesting.

The replacement awards require only one year of postformation vesting. Because employees have already rendered two years of service, the total requisite service period is three years. For simplicity, assume that New Venture estimates that there will be no forfeitures of the replacement share-based payment awards. The portion attributable to preformation vesting equals the fair-value-based measure of the contributed business's award ($20 million) multiplied by the ratio of the preformation vesting period (2 years) to the greater of the total service period (3 years) and the original service period of the contributed business's award (4 years). Thus, $10 million ($20 million × 2 ÷ 4 years) is attributable to preformation vesting and, therefore, New Venture's additional paid-in capital upon formation. The remaining $10 million is attributable to postformation vesting and therefore recognized as compensation cost in New Venture's postformation financial statements in accordance with Topic 718 on stock compensation.

New Venture applies the guidance in Topic 718 to determine whether the share-based payments should be classified as liabilities or equity.

Example 1

If New Venture determines that the replacement share-based payment awards are classified as liabilities, then total liabilities will equal $50 million ($40 million + $10 million). For simplicity, when taking the share-based payment liabilities into account, the fair value of New Venture as a whole is $90 million ($100 million – $10 million).

New Venture calculates goodwill as follows (in millions), consistent with the guidance in paragraph 805-60-30-2. The formation-date fair value of the joint venture as a whole is equal to the fair value of 100 percent of the joint venture's equity (net assets) immediately following formation (including any noncontrolling interest in the net assets recognized by the joint venture).

Fair value of New Venture as a whole (including $5 noncontrolling interest)	$	90
Less: Net fair value of identifiable assets and liabilities recognized ($120 assets - $50 liabilities)		(70)
Goodwill recognized by New Venture at formation date	$	20

New Venture calculates additional paid-in capital as follows (in millions).

Net assets recognized by New Venture, excluding share-based payment liabilities ($120 identifiable assets – $40 liabilities + $20 goodwill)	$	100
Less: The fair value of noncontrolling interest in business contributed to New Venture		(5)
Less: The fair value of preformation vesting replacement share-based payments classified as a liability		(10)
Additional paid-in capital recognized by New Venture at the formation date	$	85

New Venture records the following entry at the formation date (in millions).

Identifiable assets recognized	$ 120	
Goodwill	20	
Liabilities recognized		$ 40
Noncontrolling interest		5
Share-based payment liability (preformation vesting)		10
Additional paid-in capital		85

Example 2

If New Venture determines that the replacement share-based payment awards are classified as equity, then total liabilities will equal $40 million and the fair value of New Venture as a whole is $100 million.

New Venture calculates goodwill as follows (in millions), consistent with the guidance in paragraph 805-60-30-2. The formation-date fair value of the joint venture as a whole is equal to the fair value of 100 percent of the joint venture's equity (net assets) immediately following formation (including any noncontrolling interest in the net assets recognized by the joint venture).

Fair value of New Venture as a whole (including $5 noncontrolling interest)	$ 100
Less: Net fair value of identifiable assets and liabilities recognized ($120 assets - $40 liabilities)	(80)
Goodwill recognized by New Venture at formation date	$ 20

New Venture calculates additional paid-in capital, excluding additional paid-in capital attributable to share-based payments, as follows (in millions).

Net assets recognized by New Venture, excluding share-based payment liabilities ($120 identifiable assets – $40 liabilities + $20 goodwill)	$ 100
Less: The fair value of noncontrolling interest in business contributed to New Venture	(5)
Less: The fair value of preformation vesting replacement share-based payments classified as equity	(10)
Additional paid-in capital recognized by New Venture at the formation date (excluding additional paid-in capital attributable to preformation vesting share-based payments)	$ 85

New Venture records the following entry at the formation date (in millions).

Identifiable assets recognized	$ 120	
Goodwill	20	
Liabilities recognized		$ 40
Noncontrolling interest		5
Additional paid-in capital—share-based payments (preformation vesting)		10
Additional paid-in capital		85

The guidance allows a joint venture to apply the measurement period guidance consistent with the acquisition method for business combinations.

Measurement period considerations

The guidance allows a joint venture to apply the measurement period guidance, which is consistent with the acquisition method for business combinations. A measurement period is a period of time during which the joint venture may adjust provisional amounts recognized at

the formation date to their subsequently determined formation-date fair values. Adjustments during the measurement period are not limited to just those relating to assets acquired and liabilities assumed but apply to all aspects of joint venture formation accounting. Joint ventures are required to recognize measurement period adjustments during the period in which they determine the amounts.

The measurement period ends once the joint venture is able to determine that it has obtained all necessary information that existed as of the formation date or has determined that such information is unavailable. However, the measurement period cannot extend beyond one year from the formation date.

See section 7.3 of our FRD, ***Business combinations***, for further discussion on measurement periods.

See the Disclosure section below for a discussion of required disclosures when the amounts recognized in the joint venture standalone financial statements are provisional.

Private company alternative

A joint venture that is a private company may elect to apply the intangible asset accounting alternative, which would limit customer-related intangibles that are recognized separately to those that are capable of being sold or licensed independently from other assets of the joint venture. Companies that elect the alternative will subsume into goodwill many of the types of customer-related intangible assets that would otherwise be recognized under ASC 805. In addition, an entity that elects the alternative does not separately recognize noncompetition agreements acquired as part of the joint venture formation.

A joint venture that elects the intangible assets accounting alternative is also required to apply the goodwill amortization accounting alternative discussed below.

See Appendix D of our FRD, ***Business combinations***, for additional information.

Subsequent measurement

A joint venture should subsequently measure and account for the assets and liabilities recognized upon formation consistent with the requirements in ASC 805 and other GAAP.

Goodwill

A joint venture that recognizes goodwill and has reporting units will subsequently test the goodwill for impairment in accordance with ASC 350.[16]

For the purposes of testing goodwill for impairment in the uncommon situation in which a joint venture does not meet the definition of a business, a more than insignificant amount of goodwill is present and the joint venture has no operating segments or reporting units, the joint venture will default to testing goodwill at the entity level.[17]

Private company alternative

A joint venture that is a private company may elect to apply the accounting alternative for the subsequent measurement of goodwill, which requires goodwill to be amortized over a period of 10 years or less.

See Appendix D of our FRD, ***Business combinations***, for additional information.

Disclosure

The guidance requires a joint venture to disclose information that enables users of its financial statements to understand the nature and financial effect of the joint venture formation in the period that includes the formation date.

ASC 805-60-60-2 requires joint ventures, in the period of formation, to disclose the following:

- The formation date
- A description of the purpose for which the joint venture was formed (e.g., to share risks and rewards in developing a new market, product or technology; to combine complementary technological knowledge; to pool resources in developing production or other facilities)
- The formation-date fair value of the joint venture as a whole
- A description of the assets and liabilities recognized by the joint venture at the formation date
- The amounts recognized by the joint venture for each major class of assets and liabilities as a result of accounting for its formation, either presented on the face of financial statements or disclosed in the notes to financial statements (see paragraph 805-60-45-1)
- A qualitative description of the factors that make up any goodwill recognized, such as expected synergies from combining operations of the contributed assets or businesses, intangible assets that do not qualify for separate recognition or other factors

Additionally, if the initial accounting for the joint venture formation is incomplete and the amounts recognized in the joint venture standalone financial statements are provisional, the joint venture is required to disclose the following:

- The reasons why the initial accounting is incomplete
- The assets, liabilities, noncontrolling interests or the formation-date fair value of the joint venture as a whole for which the initial accounting is incomplete
- The nature and amount of any measurement period adjustments recognized during the reporting period, including disclosing separately the amount of adjustment to current-period income statement line items relating to the income effects that would have been recognized in previous periods if the adjustment to provisional amounts was recognized as of the formation date.

Transition and effective date

The ASU is effective for all joint ventures with a formation date on or after 1 January 2025. Early adoption is permitted in any interim or annual period in which financial statements have not yet been issued or made available for issuance, either prospectively or retrospectively. Joint ventures formed before the effective date can apply the guidance retrospectively, and those formed on or after the effective date are required to apply it prospectively.

How we see it

If a joint venture formation occurs before the effective date and the joint venture would like to recognize and initially measure the contributed assets and assumed liabilities at fair value, we believe it should early adopt the ASU rather than apply other fair value measurement approaches under current practice.

Endnotes:

[1] ASU 2023-05, *Business Combinations — Joint Venture Formations (Subtopic 805-60)*

[2] ASC 323, *Investments — Equity Method and Joint Ventures*.

[3] ASC 808, *Collaborative Arrangements*.

[4] Paragraph BC29 in the ASU's Background and Basis for Conclusions.

[5] The term joint venture is defined in the ASC Master Glossary as "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 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."

[6] See ASC 845-10-S99-2 and remarks by Christopher F. Rogers, Professional Accounting Fellow, Office of the Chief Accountant at the 2014 AICPA National Conference on Current SEC and PCAOB Developments, 8 December 2014.

[7] ASC 810, *Consolidation*.

[8] ASC 610-20, *Other Income — Gains and Losses on Involuntary Conversions*.

[9] Paragraph BC26 in the ASU's Background Information and Basis for Conclusions.

[10] Paragraph BC48 in the ASU's Background Information and Basis for Conclusions.

[11] ASC 805, *Business Combinations*.

[12] ASC 820, *Fair Value Measurement*.

[13] ASC 450, *Contingencies*.

[14] ASC 860-10, *Transfers and Servicing — Overall*.

[15] ASC 718, *Compensation — Stock Compensation*.

[16] ASC 350, *Intangibles — Goodwill and Other*.

[17] Paragraph BC49 in the ASU's Background Information and Basis for Conclusions.

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