BDO

Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

December 21, 2022

Via email to director@fasb.org

Ms. Hillary H. Salo, Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Business Combinations—Joint Venture Formations (Subtopic 805-60) (File Reference No. 2022-ED300)

Dear Ms. Salo:

We appreciate the opportunity to respond to the Board's exposure draft on the recognition and initial measurement of joint venture formations in Subtopic 805-60, *Business Combinations – Joint Venture Formations*, and support the Board's efforts to reduce diversity in practice in this area.

We agree with the Board's proposal to require a joint venture to recognize and initially measure its assets and liabilities using a new basis of accounting in a manner that is generally consistent with other business combinations. However, we believe that certain aspects of the proposal should be clarified to reduce complexity in applying U.S. GAAP and the potential for diversity in practice. We have described our suggestions in our responses to the Questions for Respondents contained in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Meredith Taylor at (571) 461-6744 and Angela Newell at (214) 689-5669.

Very truly yours,

BDO USA, LLP

BDO USA, LLP

Appendix

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.

We agree with the Board's decision to require a joint venture within the scope of the guidance to recognize and initially measure its assets and liabilities upon formation at fair value with exceptions that generally are consistent with the business combinations guidance. We believe fair value generally provides the most relevant information to the users of a joint venture's financial statements and promotes greater consistency with the venturer's accounting. However, we believe certain aspects of the proposed Update should be clarified, as described later in our response. We do not believe the Board should permit a joint venture within the scope of the guidance to recognize and initially measure its assets and liabilities upon formation at the venturers' carrying amounts, because it would not meet the Board's stated objective of reducing diversity in practice.

We also believe the scope of the guidance should be revised in two ways. First, we believe that entities that "may" be proportionately consolidated should have the option to apply this guidance. Such entities are currently excluded from the scope of the proposed guidance in ASC 805-60-15-4(d). We acknowledge that when a joint venture **is** proportionately consolidated by a venturer, using the venturer's carrying amounts may provide more decision-useful information. However, when the venturers do not proportionately consolidate the joint venture (which is an election for the venturers), using fair value in the joint venture's financial statements may be preferable. Therefore, we believe a joint venture that may be proportionately consolidated should have the option to apply the proposed guidance.

Second, we believe the scope guidance in ASC 805-60-15-4(e) may unintentionally exclude joint ventures formations that should be included within this guidance. ASC 808 does not include recognition or measurement guidance and therefore, if a joint venture is formed as part of a broader collaborative arrangement, we believe it should be within the scope of the proposed guidance. ASC 805-60-15-4(e) could either be removed or revised to state that this guidance does not apply to "A collaborative arrangement within the scope of ASC 808, except for any portion of the arrangement that is conducted in a separate legal entity that meets the definition of a joint venture."

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?

We believe the requirement that a joint venture recognize and initially measure its assets and liabilities upon formation at fair value would result in more decision-useful information for users of a joint venture's financial statements for the reasons stated in the Basis for Conclusions (BC). We defer to the users of the financial statements on how that information would 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.

We believe there may be one-time incremental costs associated with the preparer determining the fair value of the individually identifiable assets and liabilities and the equity of the joint venture. The magnitude of these incremental costs may depend on whether the investors also need to determine these amounts as a part of determining basis differences for their own equity method accounting and the materiality of the joint venture to the investors, as well as the complexity of the valuation model for the specific assets and liabilities being contributed. For this reason, we would not object to allowing a measurement period, as discussed in our response to Question 10.

Additionally, there could be recurring incremental costs associated with evaluating impairment of the joint venture's goodwill, which the investor does not need for its accounting because the investor would evaluate the equity method investment for impairment as a whole only upon an indicator of other-than-temporary impairment.[1] However, we believe the benefits of recognizing and initially measuring the assets and liabilities of the joint venture upon formation at fair value likely outweigh these costs by reducing basis differences and providing more decision-useful information.

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.

We do not expect significant basis differences between the joint venturer's financial statements and those of the venturers at initial formation for the reasons stated in paragraph BC24 of the proposed guidance. However, to avoid any diversity in practice within the accounting and valuation community and to mitigate basis differences, we believe the Board should state that

[1] We acknowledge that a joint venture could elect to amortize goodwill under the private company accounting alternative, which would reduce the risk of impairment and therefore potentially decrease costs for the joint venture itself. However, making such an election may result in basis differences for the investor, which might offset any potential cost reduction when considered on a combined basis.

the venture should not include a control premium when determining the value of its equity for purposes of valuing goodwill.

However, in certain fact patterns with contingent consideration, there could be a negative basis difference between the joint venture and the venturer. For example, if a contingent liability is recorded by the joint venture pursuant to the proposed guidance in ASC 805-60-30-1 through 6, but the receivable is not recorded by the venturer pursuant to ASC 323-10-30-2A, then a negative basis difference would arise. Similarly, a negative basis difference would arise if the joint venture recognized contingently issuable equity at fair value (see our response to Question 5 below), and the venturer did not recognize the contingent equity receivable under ASC 323-10-30-2A. To alleviate this problem, the Board could amend the guidance in ASC 323 to create symmetry between the venturer and venture. However, we acknowledge that these fact patterns are not likely to be common, and we would support continuing with the proposed guidance even if the Board decided not to amend ASC 323.

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 do not foresee any major operability or auditing concerns in recognizing and initially measuring a joint venture's assets and liabilities upon formation at fair value. However, the Board has introduced several exceptions from existing U.S. GAAP, which creates complexity. For example, the recognition of goodwill and in-process research and development (IPR&D) for all joint venture formations, including asset acquisitions, would be different from existing asset acquisition accounting in ASC 805-50 in which no goodwill or IPR&D is recognized, and also is different from the model for variable interest entities that are not businesses (for which IPR&D is recognized, but not goodwill). Additionally, the proposal introduces exceptions to other existing guidance (merger of two entities in which one must be identified as the acquirer (BC31), measuring goodwill which is not based on consideration transferred (BC47), accounting for contingent payments (BC56) and measurement period adjustments (BC64)). While we believe the Board's proposal is understandable and operable, except as noted below, we suggest the Board reconsider whether these exceptions are really needed for joint ventures. For example, we would not object to allowing a measurement period, as discussed in our response to Question 10.

However, we do not agree with the Board's proposal in ASC 805-60-25-7, which prohibits a joint venture from applying by analogy the guidance in paragraphs ASC 805-10-55-20 through 55-23 (for a transaction that in effect settles pre-existing relationships between the acquirer and the acquiree). Although the joint venture itself is the formation of a new entity, the businesses contributed to the joint venture may have pre-existing relationships with each other that may be settled as a part of the transaction.

In addition, there are two aspects of the proposed guidance that we believe may need additional clarity. One aspect of the proposal that is unclear to us relates to the measurement of equity. When determining the measurement of goodwill, the proposal is not clear whether *"100 percent of the joint venture entity's equity"* in ASC 805-60-30-2(a) and references to "outstanding equity interests" in the Summary and elsewhere is intended to represent the individually outstanding equity interests. If the intent is individually outstanding equity interests, it is not clear whether this includes equity-linked instruments (e.g., warrants, convertible debt, contingently issuable equity). We suggest the Board clarify what is part of *"100 percent of the joint venture entity's equity,"* otherwise practice may interpret this phrase differently. We believe this is important because the standard practice in the valuation community is to use enterprise value.

Finally, the proposed guidance in ASC 805-60-30-2 states that "…a joint venture shall recognize goodwill upon formation…". Based on the reference to ASC 805-20 in ASC 805-60-30-2(b), it could be interpreted that in the measurement of goodwill, all the exceptions to the recognition principle in ASC 805-20-25-17 would apply, even when the joint venture does not meet the definition of a business (i.e., asset acquisitions). For example, if a joint venture is considered an asset acquisition, it would apply the exception for income taxes in ASC 805-20-25-17(b). We acknowledge that several places in the proposed guidance state "…a newly formed joint venture would initially measure its assets and liabilities at fair value (with certain exceptions that are consistent with the business combinations guidance)." However, since there are some exceptions in the joint venture guidance from the business combination guidance (e.g., measurement period, contingent consideration), and there are no references in the corresponding sections of the codification (e.g., ASC 740) it is not clear whether "certain" is intended to encompass all the exceptions in ASC 805-20-25-17. Therefore, we suggest the Board clarify whether all the exceptions in ASC 805-20-25-17 apply to a joint venture formation, including when it would be considered an asset acquisition.

Combined response to Questions 6, 7 and 11

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.

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 definition of formation date, combined with the proposed guidance in ASC 805-60-25-4, will be understandable and operable in most transactions, for example, when substantive assets or businesses are contributed by both parties on the same date. However, when substantive assets or businesses are contributed after the joint venture is created, it may be difficult to determine the formation date; therefore, we would also support the alternative definition. As discussed in our response to Question 12, we believe that some of the difficulty in determining the formation date arises because the definition of the term "joint venture" is unclear.

However, we believe that the proposed guidance in ASC 805-60-55-2 may be viewed as inconsistent with the guidance on a formation date and the definition of a joint venture, which states "… 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..." The proposed guidance in ASC 805-60-55-2 states that the fair value of the joint venture as a whole is $100 upon the formation date. However, because this amount is nominal, some might take a view that the entity does not meet the definition of a joint venture, because it does not have sufficient resources to achieve a substantive purpose yet (i.e., risks and rewards are not yet shared), and therefore a formation date has not yet been met. We believe this could result in an interpretation that the formation date should be the legal entity formation date, even if the fair values contributed are nominal. We suggest the Board change the values in ASC 805-60-55-3 to be substantive to alleviate this concern.

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.

The recognition of goodwill and IPR&D for all joint venture formations, including asset acquisitions, would create an exception from existing asset acquisition accounting in ASC 805-50 in which no goodwill or IPR&D is recognized. As discussed above, we believe this creates complexity because it is different from other aspects of U.S. GAAP. We recommend the Board finalize this proposal, but we encourage the Board to make similar changes to the asset acquisition guidance, thereby eliminating complexity within U.S. GAAP.

We also recommend that the Board clarify whether the investors should follow the venture's accounting for IPR&D and goodwill when they apply ASC 323-10-35-13, or if the investors first should consider whether the venture meets the definition of a business, consistent with current practice. Otherwise, this may result in a negative basis difference if the venture recognizes an asset that the venturer would otherwise immediately expense in its equity method accounting.

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 do not object to the proposed amendments that joint ventures, upon formation, should capitalize IPR&D and subsequently test those indefinite-lived assets for impairment until the completion or abandonment of the associated research and development efforts. However, we also could support an alternative model in which the subsequent accounting depended on whether the joint venture met the definition of a business, as further discussed above in our responses to Questions 5 and 8.

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.

There may be circumstances in which permitting a measurement period would be beneficial. For example, venturers may determine during the negotiation process that the totality of the fair values exchanged are equal before the formation, but the venture itself may need time to determine the fair value of each individual asset that is contributed to the joint venture, especially in more complex transactions, or the value of the total equity for purposes of valuing goodwill, for example when significant synergies are expected. We would also support a separate project in which the Board introduces a measurement period for asset acquisitions, for similar reasons.

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.

We understand that despite the guidance in ASC 845-10-S99-2, there is diversity in interpreting whether the definition of a joint venture requires joint control when determining whether the business combination scope exception from ASC 805 applies. Those that view the definition of a joint venture as requiring joint control often believe they are rare in practice, while others believe the definition does not require joint control and that they are more common. We believe the Board should explicitly state in these amendments whether joint control is required. These differences in interpretation affect how often the guidance in ASC 805-60 will be applied.

We also observe that vague terms within the definition, such as “mutual benefit,” “frequently,” “usually,” and “passive investors” can be challenging to apply consistently in practice. Therefore, while we believe the Board should finalize these proposed amendments first, we also believe the Board should add a project to clarify the definition, which affects how often the guidance in ASC 805-60 will be applied. We believe the definition is important because where neither the definition of a joint venture nor of a business combination is met, it is not clear whether such entities should analogize to the proposed guidance or apply ASC 845 or other guidance. We are aware of different views on whether it is appropriate to identify an acquirer in an asset acquisition, and whether assets contributed at inception of an entity should be recognized at fair value or carryover basis. As such, we believe entities should be permitted to analogize to ASC 805-60 after this project is finalized while the Board considers whether to revise the definition of a joint venture.

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

We agree with the transition guidance in the proposed update.

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 defer to preparers on how much time they need to implement the proposed amendments. However, we believe the required adoption date should be the same for all entities since most joint ventures are private entities. We believe that early adoption should be permitted.