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December 22, 2022

Hillary H. Salo
Technical Director
Financial Accounting Standards Board
801 Main Avenue
PO Box 5116
Norwalk, CT 06856-5116

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

Dear Hillary H. Salo:

We appreciate the opportunity to comment on the proposed ASU, *Business Combinations – Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*. We support the Board's efforts to resolve diversity in practice and provide decision-useful information to investors. We believe that requiring a joint venture (JV) to measure contributed net assets at fair value provides the most relevant information to financial statement users, reduces diversity in practice and generally reduces basis differences between investors and the JV.

This cover letter describes our key observations and suggestions regarding the proposed Update. Appendix I provides our responses to the questions for respondents and includes specific recommendations for the Board to consider.

Although we believe the proposed Update would represent an improvement and provide helpful guidance, we believe the final standard could be simplified and made more operational as follows.

1) Use a contribution-by-contribution approach

We recommend that the Board consider a contribution-by-contribution approach versus the approach in the proposed Update. Under a contribution-by-contribution approach, all contributions from an owner to a JV, whether contributed at formation or subsequent to formation, would be accounted for by the JV:

a) at fair value on the date the JV obtains control of the net assets using the fair value of the investor's interest received (or retained) in the JV as the purchase price to allocate to the net assets;
b) according to their nature – as either an asset acquisition or a business combination.

We are using the term 'contributions' broadly to include both transactions where the investor transfers assets to the JV and deconsolidation transactions where the retained investment of the previous parent is in a JV. We believe our proposed approach would simplify and improve operationality in three main ways.

Reduces basis differences

The contribution-by-contribution approach would simplify and improve operationality by reducing basis differences. It would do this by aligning the measurement date and measurement methodology of the investor and JV. In contrast, the proposed amendments may still give rise to certain basis differences and in some cases (depending on the method a JV presently uses to determine fair value) increase basis differences. The following are examples of basis differences that may be created by the proposed amendments that would be mitigated by a contribution-by-contribution approach.

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Basis difference	Proposed amendments	Contribution-by-contribution approach
Valuing the JV based on 100% of the equity	While the investor would measure its investment at fair value and the JV would measure its assets at fair value, the method for determining that fair value would be different and may result in a negative basis difference between the investor and the JV (i.e. JV's fair value is greater than the investor's).	The investor and JV would generally use the same fair value to measure the transaction.
Different measurement dates	The investor measures its investment at fair value upon derecognition (if a business under Topic 810 or financial asset under Topic 860) or at contract inception (under Subtopic 610-20). These dates may be different than the JV formation date. As a result, these differing measurement dates could lead to additional basis differences and to incremental costs of valuing the contribution at different dates.	Each contribution would have its own measurement date and generally use the same measurement for both the JV and investor. This approach is also consistent with the Board's proposal for transfers of financial assets, which requires applying the same guidance as the transferor (Topic 860).
Applying business combination guidance to contributions of non-businesses	Under current practice if the JV is not a business, an investor uses an asset acquisition model to identify basis differences as if the investee were a consolidated subsidiary. For example, if the JV is not a business the investor would not record equity method goodwill and an in-process research and development asset would be expensed in the investor's memo accounts. Under the proposed amendments it is unclear whether the investor would follow the JV's characterization of net assets contributed when the net assets do not meet the definition of a business.	The investor's accounting generally would be aligned with the JV. Conversely, the proposed amendments may create a disconnect between what the JV records and what the investor records in its memo accounts.

Eliminates need for definition of formation date

A contribution-by-contribution approach would eliminate the need to identify a single measurement date for multiple transactions because each contribution would be accounted for separately. Therefore, a single measurement date would not be required. We believe there are operational challenges associated with the formation date definition (see Questions 6 – 8 in Appendix I) that would no longer be an issue under a contribution-by-contribution approach.

Reduces judgment required to determine what is part of the transaction

A contribution-by-contribution approach would eliminate the need to provide specific guidance on what transactions to combine into a single formation transaction (i.e. Day 1) because subsequent transactions (Day 2) would be accounted for consistently with the formation transaction(s). In contrast, the proposed amendments would require the JV to combine multiple transactions with multiple investors into a single formation transaction, which would introduce additional complexity.

In addition, since there is diversity in practice around the guidance that should be applied to a subsequent contribution from an investor to a JV that is not a business, the contribution-by-contribution approach would further reduce diversity in Day 2 accounting. The following example illustrates our suggested approach.

<table>
<tr><th colspan="2">Facts</th></tr>
<tr><td colspan="2">— On January 1, Investor A and Investor B each contribute $25 and together form a 50/50 JV that they account for under the equity method.
— On March 31, Investor A contributes a business with a fair value of $150.
— On April 30, Investor B contributes in-process research and development (IPR&D) with a fair value of $150.</td></tr>
<tr><th colspan="2">Accounting under contribution-by-contribution approach</th></tr>
<tr><td>January 1</td><td>Each Investor records equity method investment of $25. The JV records $50 of cash.</td></tr>
<tr><td>March 31</td><td>The JV records the contributed business at fair value of $150 and Investor A records an additional equity investment of $150.</td></tr>
<tr><td>April 30</td><td>The JV records IPR&D expense of $150 and Investor B records an additional equity investment of $150. Investor A and B then adjust their respective equity method investments to record $75 of the loss.</td></tr>
<tr><td colspan="2">In summary, at April 30 (assuming no other profits or losses), Investor A would have an investment of $100 (i.e. $25, plus $150, minus $75), Investor B would have an investment of $100 (i.e. $25, plus $150, minus $75) and the JV would have net assets of $200.</td></tr>
</table>

In contrast, under the proposed amendments, the JV would first need to determine the formation date (which may be January 1) and measure the contributed assets and 100% of the entity's equity at that date. That date would be different than the date the investors measure their respective equity method investment at fair value and therefore could lead to basis differences and incremental costs by requiring multiple fair value measurements for the same transaction. Further, the IPR&D would be recognized as an indefinite lived intangible asset, possibly resulting in a different basis than the investors'.

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2) Define JV formation transactions

Because the proposed amendments do not define a JV formation transaction, we believe it could be challenging to apply the proposed JV formation definition and identify what is part of the formation transaction. Further, we believe it is unclear whether the proposed Update would apply only to newly formed legal entities or would also apply to transactions where a new venturer obtains an interest in an existing entity.

We believe our suggested contribution-by-contribution approach eliminates the need to define a formation transaction. However, if the Board continues with the approach in the proposed Update, we suggest defining JV formation transactions and clarifying whether the scope is limited to newly formed legal entities (see Question 6 for recommendations).

3) Update the definition of a JV

The definition of a JV is often challenging to apply given the qualitative factors that must be considered when evaluating the definition. We suggest amending the definition of a JV as follows to focus on joint control rather than the qualitative aspects about the purpose of the entity.

> **Joint Venture**
> A legal entity owned and operated by more than one investor (the venturers) in which the relationship between the venturers is governed by an agreement (usually in writing) that establishes joint control. Significant financial and operating decisions that are made in the entity's ordinary course of business (if it is a voting interest entity) or that most significantly affect the entity's economic performance (if it is a variable interest entity) require the unanimous consent of all of the venturers; none of the individual venturers has a controlling financial interest in the entity. This feature of joint control distinguishes joint ventures from other enterprises in which the investors do not have equal decision-making rights. An entity that is a consolidated subsidiary of one of the venturers is not a joint venture.

We believe focusing on joint control aligns the definition to the consolidation models. When there is joint control, we believe it is appropriate that the transaction is scoped out of Topic 805 on business combinations because neither one of the parties would be the acquirer. Further, a new basis is appropriate because establishing joint control establishes a new reporting entity. For cost-benefit reasons we believe that new basis should be measured as the fair value of the net assets contributed by the investors.

* * * * *

If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Kimber Bascom at kbascom@kpmg.com or Nick Burgmeier at nburgmeier@kpmg.com.

Sincerely,

KPMG LLP

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Appendix I – Responses to Questions for Respondents

New Basis of Accounting

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 that a JV should recognize and initially measure its assets and liabilities at fair value and that carryover basis (investor's basis before derecognition) should not be required. We believe requiring fair value measurement would reduce diversity in practice and the amount of basis differences between the JV and its venturers. However, as described in our cover letter we believe there are opportunities to simplify the guidance and make it more operational.

We also believe the Board should not permit a JV to use carryover basis. Allowing optionality would retain diversity in practice, which is counter to the objective of the proposed amendments.

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?

Yes. We agree that the formation of a JV conceptually creates a new reporting entity and therefore a new basis of accounting provides decision useful information. The pre-JV carrying amounts of the assets and liabilities are not relevant to the new JV's operations and those amounts do not reflect the JV's joint activity. Further, a new basis would provide financial statement users with information about how the investors assessed the value of the contributed net assets and would allow the subsequent reporting to reflect the use of and changes in value of those assets after formation.

However, as described in our cover letter, we believe a contribution-by-contribution approach would reduce basis differences and make the final standard more operational because it would require a JV to account for investors' contributions according to their nature (as either an asset acquisition or business combination) and use the same measurement principles the investors use upon derecognition of the net assets contributed.

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.

It depends. When compared to the present practice of using fair value, the proposal likely would require minimal additional costs. However, when compared to the present practice of using carryover basis, we believe the proposal would impose incremental costs, including but not limited to:

— one-time cost of measuring the fair value using 100% of the JV's equity interest;

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- one-time cost of measuring the net assets at fair value under Subtopic 805-20; and
- ongoing cost related to the subsequent accounting for goodwill and intangible assets (e.g. annual impairment tests of goodwill and/or indefinite lived intangible assets).

Although the proposed amendments may impose incremental costs, we believe those costs are mitigated because each investor is already required to measure its investment at fair value and prepare memo purchase price allocations to account for its equity method investment. However, under the proposed amendments the measurement basis and date may be different. Therefore, we believe the approach we suggest in our cover letter mitigates the costs because it more closely aligns the measurement date and method with the investors'.

Further, we believe the costs do not outweigh the benefits of the fair value approach given reduced diversity and increased relevance of the information provided to financial statement users (see Question 2).

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 believe the proposed Update would reduce basis differences compared to situations where a JV presently uses carryover basis. However, the proposed amendments may still give rise to certain basis differences and in some cases (depending on how a JV presently determines fair value) increase basis differences. We believe there is an opportunity for further simplification and to further reduce basis differences by using our suggested contribution-by-contribution approach.

The following are examples of basis differences that may be created by the proposed amendments that would be mitigated under a contribution-by-contribution approach.

Valuing the JV based on 100% of the equity	The fair value of 100% of the JV's equity generally would include a control premium while the fair value of the venturers' noncontrolling equity method investment generally would not. This could result in a negative basis difference between the investor and the JV.
Applying business combination guidance to contributions of non-businesses	If the JV is not a business, it is unclear whether the investor would apply asset acquisition accounting in its memo accounts, giving rise to several basis differences (e.g. the investor would not record goodwill and IPR&D assets in its memo accounts), or would follow the JV's characterization of the contributions.
Single measurement date	The investor measures its investment upon derecognition (under Topic 810 if a business or Topic 860 if a financial asset) or at contract inception (under Subtopic 610-20). These dates may be different than the JV formation date, which is the date the entity meets the definition of a JV. Using different measurement dates could lead to additional basis differences.

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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.

Applying a business combination approach (Subtopic 805-20) to the assets and liabilities contributed would generally be operable given it is well established in practice. However, we believe our suggested contribution-by-contribution approach would improve the operationality of the overall model, for which our primary concerns are discussed in Questions 4 and 6 - 9.

We believe the Board should also provide guidance on whether and/or how a JV should present periods before the formation date. For example, if an existing legal entity with substantive operations later meets the definition of a JV (e.g. another investor contributes assets or a business) requiring new basis for the pre-existing and contributed assets, it is unclear whether that entity should show comparative financial statements with a blackline separating the periods before and after the formation date (similar to push down accounting and fresh start accounting). We believe adding guidance on whether periods before the formation date or comparative financial statements should be included would provide clarity and reduce the potential for diversity in practice.

Determining the Formation Date

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.

We believe our suggested contribution-by-contribution approach would eliminate the need for a formation date definition and would simplify the guidance because it aligns the JV's measurement with the date the JV obtains control of the net assets (i.e. generally the contribution date). Our suggested approach also more closely aligns the measurement date with the investor's measurement date.

We believe the proposed formation date definition may be challenging to apply because that date could be disconnected from the transactions the proposed ASU is attempting to address. That is, the proposed amendments primarily provide guidance for how a JV recognizes and measures contributions from investors. However, the formation date may not align with the contribution date(s) because the formation date is not based on the date(s) the JV obtains control of the net assets. Therefore, the date on which the net assets are measured may be different from the date(s) the JV recognizes the assets and the date(s) the investors measure their investments. This misalignment may be particularly challenging in a JV arrangement given that investors often contribute assets over time.

If the Board continues with its proposed approach, we believe it should further clarify the formation date. We believe the first step in clarifying the formation date is to define a JV formation transaction. This is necessary to appropriately establish the scope of the proposed guidance and clarify to which transactions the formation date relates. Further, it is unclear whether under the proposed amendments a JV formation requires the establishment of a new entity or whether an existing operating entity could subsequently meet the definition of a JV. Without this clarification, there may be opportunities to structure in or out of the scope of the guidance or create diversity in practice.

If the Board does not intend to require the establishment of a new legal entity to have a JV formation, we believe a JV formation transaction definition similar to the below would be helpful to define the scope.

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Joint venture formation
A joint venture formation is a transaction in which the investors contribute substantially all of the net nonmonetary assets required to obtain their ownership interest in an entity that meets the definition of a joint venture. Examples of formation transactions include:

a) the venturers contribute substantially all of the net assets to a newly formed entity that meets the definition of a joint venture;
b) a new investor contributes net assets to an existing entity and after the transaction the entity meets the definition of a joint venture; and,
c) the investor sells an ownership in an entity and/or there is a change in governance such that the existing entity meets the definition of a joint venture.

Once the type of transaction in scope is established, we believe the definition of formation date should flow from that definition. For example, using the above definition of a JV formation, we believe that the formation date should be the later of the date the entity initially meets the definition of a JV and the date the formation transaction is completed (e.g. the JV obtains control of substantially all of the net nonmonetary assets required to be contributed by owners).

We believe at minimum the Board should clarify whether this Update applies only to newly formed legal entities. We do not believe that this was the Board's intent; however, absent clarification entities would need to apply judgment to identify a formation transaction leading to the potential for diversity in practice, which is counter to the Board's objective.

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 believe it may be difficult to identify a single measurement date that applies to multiple transactions from multiple counterparties. This is particularly true with JVs because multiple parties may transfer assets to a JV at different times or over time.

We believe our suggested contribution-by-contribution approach would better align the JV's accounting with the investors' accounting under both Subtopic 610-20 and Subtopic 810-10. That is, accounting for each transaction as it occurs at fair value would better align the JV's measurement date with the investor's. The contribution-by-contribution approach is also consistent with the Board's proposal to require the JV to apply Subtopic 860-10 when the investor transfers financial assets.

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<u>Goodwill</u>

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 believe our recommended contribution-by-contribution approach that accounts for each transaction according to its nature (asset or business) would be more operable and better align with the amounts the investor records for its investment. For example, if a single asset is contributed, the proposed amendments would require the JV to determine if goodwill exists by comparing the fair value of 100% of the JV's equity to the fair value of that asset. Using the asset acquisition model under the contribution-by-contribution approach, the entire fair value is simply allocated to the single contributed asset, which reduces the need for a separate valuation of the asset.

If a JV accounts for all contributions received under the business combination model, there could be a disconnect in how the investor accounts for and identifies its basis differences under the equity method. Currently, an investor's memo purchase price allocation depends on whether the investee is an asset or a business. That is, the investor only identifies equity method goodwill if the investee is a business. For example, in a single-asset JV that is not a business, under current practice the investor would assign the cost of its investment entirely to the single asset; requiring the investor to account for equity method goodwill would result in basis differences between the investor and JV.

Under the proposed amendments, it is not clear whether the investor preparing its memo accounts would be required (or permitted) to evaluate whether the JV is a business or use the proposed amendments. We believe our suggested approach would mitigate the complications described above. However, if the Board continues with the approach in the proposed Update, we recommend clarifying whether an investor should prepare its memo purchase price allocation consistent with the proposed amendments or based on whether or not the JV is a business.

<u>In-Process Research and Development (IPR&D)</u>

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 believe our suggested approach to account for each transaction as an asset or business would be more operable and better align a JV's accounting with the investors' accounting. Under our suggested approach, the IPR&D would be accounted for under an asset acquisition model or business combination model depending on the nature of the contribution.

However, if the Board moves forward with its proposal to use the business combination model for all transactions, we believe accounting for IPR&D consistent with a business combination is appropriate.

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<u>Measurement Period</u>

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 believe there are merits to either approach. While the measurement period often introduces complexity there may be situations when a measurement period is helpful to financial statement preparers (e.g. when two large businesses are contributed).

We believe that our suggested contribution-by-contribution approach would mitigate the need for a measurement period for two reasons.

1. The measurement date(s) would more closely align with the investor's.
2. The requirement to separately value 100% of the JV's equity at the formation date (which is something the investor likely would not do) would be eliminated.

<u>Determining What is Part of the Joint Venture Formation</u>

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.

The guidance the proposed amendments leverage (from Subtopic 805-20 and Subtopic 810-10) are well established and generally understandable. However, we believe the guidance may be challenging to apply under the proposed amendments for three reasons.

1. There is no definition of a JV formation and therefore it is unclear exactly which transactions should be combined into a single JV formation transaction (see Question 6).
2. The guidance is typically applied to transactions between two counterparties (buyer and seller) while the way the proposed amendments work would require evaluating multiple transactions between three or more reporting entities (the JV itself and investors).
3. The nature of JVs often involves contributions of assets over time (e.g. delayed contributions) and/or different investors contributing at different times.

However, because our proposed contribution-by-contribution approach would account for transactions between the owners and a JV as they occur, it would reduce complexity by focusing only on the transaction between the owner and the JV rather than trying to evaluate multiple transactions with multiple investors. Further, the contribution-by-contribution approach would mitigate most of the concern of combining transactions because the measurement basis for formation and subsequent transactions would be consistent.

Definition of a Joint Venture

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 believe the proposed scope of Subtopic 805-60 is narrow and the JV definition is often challenging to apply given the qualitative factors that must be considered. We suggest amending the definition of a JV to focus on joint control rather than qualitative aspects about the purpose of the entity. See our suggested definition in the cover letter.

We believe focusing on joint control updates the definition to be consistent with the consolidation models. When there is joint control, we believe it is appropriate that the transaction is scoped out of Topic 805 on business combinations because neither one of the parties would be the acquirer and new basis is appropriate as a significant event that established a new reporting entity.

Transition and Effective Date

Question 13:

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

Yes, 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 believe the proposed amendments can be implemented in a short period of time given the narrow scope and prospective transition method. We believe 12 months or fewer is a reasonable period. We believe that both public and private entities could adopt at the same time, especially because JVs are typically private, which would simplify the transition. We also believe early adoption should be permitted.