The Association of
Accountants and
Financial Professionals
in Business

via email
To: director@fasb.org

December 30, 2022

Ms. 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 Ms. Salo:

The Financial Reporting Committee (FRC or Committee) of the IMA® (Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board (FASB or Board) Proposed Accounting Standards Update, *Business Combinations—Joint Venture Formations (Subtopic 805-60):* Recognition and Measurement, File No. 2022-ED300 (Proposed Update).

The IMA is a global association representing over 140,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

The Committee supports the Board's efforts to resolve diversity in practice and provide decision-useful information to investors and other financial statements users through guidance about how a joint venture (JV) should recognize and initially measure assets contributed and liabilities assumed at its formation. We agree that fair value is the most relevant measurement attribute for such transactions and may reduce basis differences between investors and the JV.

The Committee believes the following revisions to the Proposed Update would enhance the operability and relevance of the guidance and reduce the cost of application:

- Expand the scope of the guidance to address all contributions of net assets received by a JV from its investors over the course of the JV's existence and not only those at its formation.
- Measure the fair value of the net assets contributed to the JV as of the date(s) the JV obtains control of the net assets contributed using the same fair value measurement guidance as the investor uses to measure its interest in the JV.
- Limit the application by the JV of the recognition guidance in Topic 805, *Business Combinations*, on business combinations to contributions received that meet the definition of a business.

In combination these recommendations comprise a model under which all contributions from an investor to a JV, whether at formation or subsequent to formation, would be recognized by the JV when it obtains control of the net assets according to their nature – as either an asset acquisition or business combination – and measured by the JV using the fair value of the investor's interest in the JV. This would mitigate the cost of application by aligning the measurement date and measurement methodology used by the JV and its investors, thereby reducing the potential for basis differences between the investor and the JV, without diminishing the relevance of the reported information. It also would simplify the guidance and eliminate the need to further develop other aspects of the Proposed Update.

The Committee also recommends that the Board clarify the definition of a JV. Our views are discussed in further detail below.

***Address all contributions of net assets received by a JV from its investors***

We recommend that the FASB expand the scope of the guidance to include all contributions from an investor to a JV, whether contributed upon, or subsequent to, formation of the JV. The guidance in the Proposed Update on the formation date of a JV is ambiguous and could represent a date before or after an entity is formed. In addition, if contributions from the JV's investors do not occur simultaneously, or occur over time, which is frequently the case, it is unclear whether a single measurement date, or multiple measurement dates, would be used in applying the guidance and whether some of the investors' contributions would be excluded.

The following illustrative fact pattern highlights some of the challenges of applying the proposed JV formation guidance:

- On January 1, 20X3, Investor ABC and Investor DEF reach an informal agreement to form JV
- On February 1, 20X3, the agreement between ABC and DEF is formally memorialized and executed
- On February 1, 20X3, ABC and DEF both contribute $1,000 to JV, which is used by JV to cover its initial organization costs (legal fees, etc.)
- On April 1, 20X3, ABC contributes real estate that it had owned for 5 years and that does not meet the definition of a business to JV; the real estate has a fair value of $1 million on that date

- On July 1, 20X3, DEF contributes newly acquired equipment that does not meet the definition of a business to JV; the equipment has a fair value of $500,000 on that date
- On August 1, 20X3, ABC and DEF each contribute $400,000 to JV; on that date JV also hires employees and meets the definition of a business
- On January 1, 20X5, ABC contributes a business that it had owned for 10 years to JV; the business has a fair value of $5 million on that date
- On July 1, 20X5, DEF contributes a business that it had owned for 7 years to JV; the business has a fair of $5.5 million on that date

In the fact pattern above, it is unclear which dates comprise the JV formation for purposes of applying the guidance in the Proposed Update. If the JV formation comprises multiple dates, it is unclear whether the fair values at each of those dates, or the fair values at only a single date, should be used to measure the net assets contributed. Using the fair values at a single date would not be operable if the JV formation comprised multiple dates including July 1, 20X3, but the measurement was performed as of a date preceding July 1, 20X3, because the equipment contributed on that date was not acquired by DEF before then.

The JV's measurement date under the proposed formation date guidance may be different from the date(s) on which the JV recognizes the net assets contributed and the date(s) the investors measure their investments because the guidance is not based on the date(s) the JV obtains control of the net assets.

Expanding the scope of the guidance as we recommend would eliminate the need to clarify and define the formation date. It would also be more operational because it would generally align the JV's measurement with the date the JV obtains control of the net assets (generally the contribution date), which would generally also be the investor's measurement date. This would reduce the cost of application and reduce the potential for structuring transactions to avoid being within the scope of the guidance. For these reasons the Committee does not believe it would be necessary for the FASB to issue a revised exposure draft to expand the scope as we propose. If the Board decides to continue with its proposed approach, we believe it should clarify the formation date to address the questions raised by the illustrative fact pattern above.

***Use the fair value of the investors' individual contributions to measure the JV's net assets***

We recommend that the Board require investor contributions received by a JV that are within the scope of the guidance be measured at fair value as of the date(s) the JV obtains control of the net assets contributed using the same fair value measurement guidance as the investor uses to measure its interest in the JV (i.e., upon derecognition of a business by the investor under Topic 810, *Consolidation*, or a financial asset under Topic 860, *Transfers and Servicing*, or at contract inception for other assets under Subtopic 610-20, *Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets*). We further recommend that the Board define the term contributions so that it comprises both transactions in which the investor transfers net assets to the JV as well as deconsolidation transactions in which the investor's (previous parent company's) retained investment is in a JV as a result of contributions to the entity from one or more other investors. We believe our proposed approach would simplify the guidance and improve its operationality by reducing basis differences between the investor and the JV because it would align the measurement date and measurement methodology used by each. It would also lower the cost of application as compared to the guidance in the Proposed Update because there would be fewer fair value measurements to perform (i.e., there would be no need to determine the fair value of the JV's net assets using the fair value of 100% of its equity).

***Do not apply the recognition guidance on business combinations to asset acquisitions***

The Proposed Update would require a JV to apply the recognition requirements in Topic 805 on business combinations to all in-scope contributions received from its investors, regardless of whether those contributions meet the definition of a business. This would result in recognition of goodwill upon JV formation in many cases in which the net assets contributed do not meet the definition of a business because of the proposed requirement to measure the net assets using the fair value of 100% of the JV's equity. Recognizing goodwill in these circumstances also would be inconsistent with the guidance in Topic 810, which prohibits the primary beneficiary of a variable interest entity (VIE) that is not a business from recognizing goodwill on consolidation of the VIE. In addition, in-process research and development (IPR&D) contributed as part of a JV formation would be capitalized even when the IPR&D is not part of a contributed business and does not have an alternative future use.

The Committee believes it would be better for the FASB not to align the accounting for asset acquisitions and business combinations solely for JV formation transactions, particularly given that the Board recently removed the project on improving the accounting for asset acquisitions and business combinations, as well as the project on identifiable intangible assets and subsequent accounting for goodwill, from its agenda. Instead, we recommend that a JV follow the recognition guidance for asset acquisitions when the net assets contributed by the investor do not meet the definition of a business, and the recognition guidance for business combinations when the net assets contributed meet the definition of a business. Using the illustrative fact pattern above and assuming the Board accepts the Committee's above recommendations, this would mean the recognition guidance in Topic 805 would only apply to the contributions on January 1, 20X5 and July 1, 20X5. The Committee also recommends that the Board require a JV to follow the guidance on measuring contingent consideration in a business combination (both on acquisition and subsequently) and permit a JV to make measurement period adjustments in the same manner as the acquirer of a business when the net assets contributed by the investor meet the definition of a business. These changes would help to reduce potential basis differences between the investor and the JV and also limit inconsistencies within GAAP relative to the applicability of the business combinations guidance and the manner of its application (e.g., with respect to measurement period adjustments).

***Clarify the definition of a JV***

The Committee recommends that the Board improve the definition of a JV in the Proposed Update to clarify the following matters:

- Whether a JV formation is limited to the establishment of a new entity or whether it could also apply to a change in circumstances (governance, etc.) involving an existing entity that causes the entity to meet the definition of a JV. The Committee believes the guidance should apply both to newly created entities and to existing entities that meet the definition of a JV as a result of a change in circumstances because otherwise application of the guidance could become somewhat optional.
- Whether the investors in an entity need to share joint control of the entity's significant financial and operating decisions made in the ordinary course of business (if it is a voting interest entity) or that most significantly affect its economic performance (if it is a variable interest entity). The Committee believes this should be a requirement. In addition, we believe the Board should clarify that it is not necessary for the investors to have substantially equivalent levels of ownership for the entity to be a JV. Conversely, we do not believe the focus of the current definition of a Corporate Joint Venture in the Master Glossary on the objective of the entity's investors or the typical purposes for which such entities are established serves to sufficiently define the population of entities for which the guidance is intended.

* * * *

We appreciate the opportunity to provide comments on the Proposed Update and would be pleased to discuss our comments with the FASB or its staff at your convenience.

Sincerely,

Josh D. Paul
Chair, Financial Reporting Committee
Institute of Management Accountants
jpaul@paloaltonetworks.com