

To the Point

FASB – proposed guidance

Proposal would amend guidance for identifying the accounting acquirer in acquisitions involving VIEs

The proposal would more closely align the requirements for identifying the accounting acquirer in the acquisition of a VIE with those that apply to acquisitions that involve voting interest entities.

What you need to know

- ▶ The FASB proposed amending the guidance for identifying the accounting acquirer in an acquisition achieved primarily through an exchange of equity interests in which the legal acquiree is a variable interest entity that meets the definition of a business.
- ▶ The proposal would require the consideration of the factors in ASC 805 that are currently applied when identifying the accounting acquirer in an acquisition involving voting interest entities.
- ▶ Entities would apply the guidance prospectively to acquisitions that occur on or after the effective date. Early adoption would be permitted.
- ▶ Comments are due by 16 December 2024.

Overview

The Financial Accounting Standards Board (FASB or Board) proposed amending Accounting Standards Codification (ASC) 805, *Business Combinations*, to require entities to consider existing factors in ASC 805 when identifying the accounting acquirer in a transaction achieved primarily through an exchange of equity interests in which the legal acquiree is a variable interest entity (VIE) that meets the definition of a business.

The proposal, which is based on a recommendation by the Emerging Issues Task Force (EITF), would more closely align the requirements for identifying the entity that is considered the acquirer for accounting purposes (i.e., the accounting acquirer) when evaluating the acquisition of a voting interest entity.

The proposal is in response to stakeholder feedback that said the current guidance for determining the accounting acquirer results in a lack of comparability of financial statements across entities engaging in economically similar acquisition transactions.

Under the current guidance, when one entity legally acquires another entity, the accounting for the transaction depends on which entity is considered the accounting acquirer. The accounting acquirer is the entity that has obtained control of another entity (i.e., the accounting acquiree). To identify the accounting acquirer, entities first consider the VIE model in ASC 810-10, *Consolidation*. If the legal acquiree is a VIE, the primary beneficiary of the VIE is always the accounting acquirer.

However, if the legal acquiree is not a VIE, and the determination of the accounting acquirer is not clear, all of the following factors in ASC 805-10-55-11 through 55-15 need to be considered to identify the accounting acquirer:

- ▶ Relative voting rights in the combined entity
- ▶ Existence and size of a single minority voting interest in the combined entity
- ▶ Composition of the governing body
- ▶ Composition of management
- ▶ Relative size of the combining entities
- ▶ Terms of the exchange of equity interests

Stakeholders have noted that the current guidance prohibiting entities from considering the factors in ASC 805 to identify the accounting acquirer when the legal acquiree is a VIE affects not only the determination of which entity is the accounting acquirer, but also whether a business combination has occurred. Accordingly, the accounting and financial statement presentation can differ significantly for acquisition transactions involving VIEs compared to those not involving VIEs, even though the transactions may be economically similar.

Key considerations

Under the proposal, entities would be required to consider the factors in ASC 805 to identify the accounting acquirer when a VIE that is a business¹ is legally acquired primarily through the exchange of equity interests. In some cases, this would result in the identification of an accounting acquirer that would be different than if the primary beneficiary (the legal acquirer) were determined to be the accounting acquirer.

The accounting for the transaction as a business combination could also be affected. For example, if the legal acquiree (i.e., the VIE) were identified as the accounting acquirer under the proposed amendments, the accounting for the acquisition would depend on whether the legal acquirer (i.e., accounting acquiree) is a business. Transactions in which the legal acquiree (accounting acquirer) obtains control of the legal acquirer (accounting acquiree) that meets the definition of a business results in a reverse acquisition that would be accounted for as a business combination. However, if the legal acquirer (accounting acquiree) is not a business, the transaction would be accounted for under other applicable US GAAP (e.g., asset acquisition, reverse recapitalization).

Scope

Acquisitions of VIEs that meet the definition of a business

The guidance would apply to acquisitions of VIEs that meet the definition of a business in ASC 805. As part of its deliberations, the Board considered expanding the scope to include transactions involving VIEs that are not businesses. The Board decided that broadening the scope would require the consideration of a wider range of practice issues and, accordingly, the Board decided to limit the scope of its proposal to narrowly address the practice matter raised in the EITF agenda request.²

Acquisitions effected primarily through the exchange of equity interests

The proposal would require the assessment of the factors in ASC 805 only when a VIE that meets the definition of a business is legally acquired in a transaction achieved primarily through the exchange of equity interests. The Board clarified that many of the factors used to determine the accounting acquirer are tailored to address such transactions, and therefore, it decided to propose narrow amendments to the existing guidance.³

Application of the factors

The proposed amendments would not change the factors in ASC 805 that entities are currently required to consider when identifying the accounting acquirer in transactions involving voting interest entities. The Board noted that application of the factors to transactions involving VIEs would better align the financial reporting outcomes with both the economic substance of the transactions and the current requirements for acquisitions of voting interest entities.⁴

How we see it

We generally expect that the proposal will address certain acquisition transactions in which the current accounting outcome (i.e., a forward merger accounted for as a business combination) sometimes does not align with the transaction's economic substance (i.e., a reverse acquisition or reverse recapitalization).

Transition, early adoption, and effective date

Entities would apply the guidance prospectively to all acquisitions that occur on or after the effective date. Early adoption would be permitted. The effective date will be determined after the Board considers stakeholder feedback.

Endnotes:

¹ As defined under ASC 805.

² See paragraph BC32 of the proposed ASU's Background Information and Basis for Conclusions.

³ See paragraph BC34.

⁴ See paragraph BC36.