STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**IFRS 3 *Business Combinations***
Paper topic	Accounting for reverse acquisition transactions where the acquiree is not a business

CONTACT(S) Denise Durant ddurant@ifrs.org +44 (0)20 7246 6469

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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received two requests to provide guidance to account for two reverse acquisition transactions in which the accounting acquiree is not a business. This is because IFRSs do not provide explicit guidance for this particular type of transaction and there is diversity in practice.

2. The submissions are reproduced in Appendix B and C of this paper.

Purpose of the paper

3. This paper:

   (a) provides background information on the issue;

   (b) analyses the issue within the context of IFRSs;

   (c) assesses the issue against the Interpretations Committee's agenda criteria and the annual improvements criteria;

   (d) includes the staff recommendation; and

   (e) asks questions to the Interpretations Committee.

Background information

4. A brief description of the two submissions received is provided below.

First submission

5. The first submission (included in Appendix B) refers to the case of a non-listed operating entity that creates a special purpose acquisition company (SPAC, hereafter referred to in this section as 'Entity A') that will obtain a public listing through an initial public offering (IPO).

6. Entity A is a non-operating shell entity with no ongoing activities. Its net assets consist of cash only.

7. Entity A (the 'legal acquirer') acquires an existing non-listed operating entity (Entity B, the 'legal acquiree'). Both entities then merge to form one legal entity (hereafter referred to as 'Entity AB').

8. The objective of this transaction is for Entity B to obtain a market listing status without needing to undergo its own IPO and all the reporting requirements that an IPO typically entails.

9. Entity A issues shares in exchange for the shares of Entity B such that the shareholders of Entity B gain control of Entity AB and the respective ownership interests in entity AB reflect the relative fair values contributed by each shareholder group.

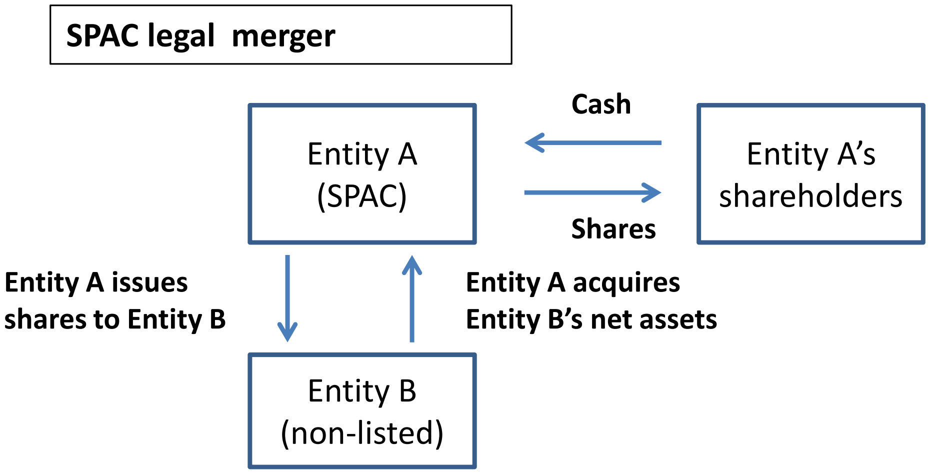
10. The submitter asserts that IFRSs do not explicitly provide the accounting treatment of this particular type of transactions.

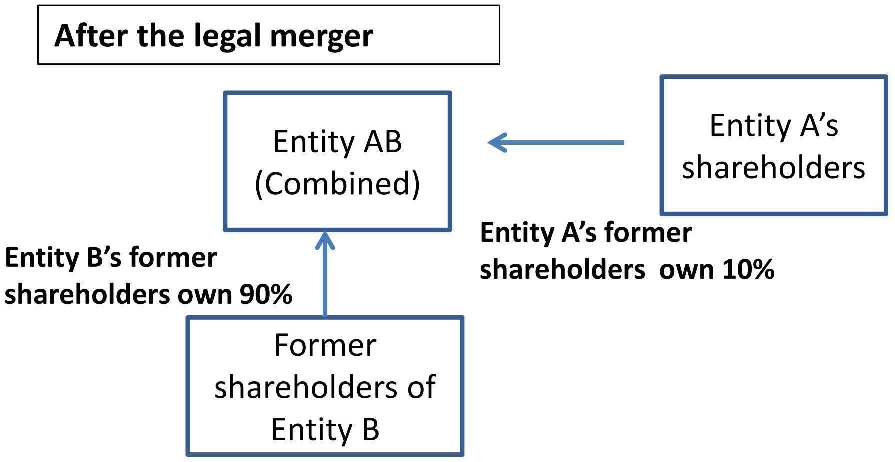
11. The submitter claims that the transaction could be considered to be in substance a reverse acquisition (as defined in paragraph B19 of IFRS 3 *Business Combinations*). This is because after the legal merger (using the numbers given in the example included in the submission):

    (a) the former shareholders of Entity B own 90 per cent of the shares of Entity AB and have control of Entity AB;

(b) the former shareholders of Company A own 10 per cent of the shares of Entity AB.

12. The following diagram illustrates **the first fact pattern** submitted:


SPAC legal merger
Cash
Entity A
(SPAC)
Entity A's
shareholders
Shares
Entity A issues
shares to Entity B
Entity A acquires
Entity B's net assets
Entity B
(non-listed)


After the legal merger
Entity AB
(Combined)
Entity A's
shareholders
Entity A's former
shareholders own 10%
Entity B's former
shareholders own 90%
Former
shareholders of
Entity B

13. The submitter observes that, legally, Entity A acquired the shares of Entity B. However, the former shareholders of Entity B could be considered to be the 'accounting acquirer' in this transaction, on the basis of the guidance in paragraph B19 of IFRS 3, because it has control of the combined entity. However, Entity A cannot be considered to be the 'accounting acquiree' in a business combination in this transaction, because Entity A does not meet the definition of a *business* in IFRS 3 (ie paragraphs B7-B12).

14. The submitter further notes (emphasis added):

> A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world.
>
> However, **the conflicting interpretations supported by Big 4 accounting firms and US-GAAP with respect to SPAC related mergers, i.e., charging any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell company to ‘expense’ (Big 4 accounting firms) or to ‘equity’ (US-GAAP), are causing more confusion in practice**.
>
> Therefore, the IASB should provide standards for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

15. The submitter notes that the following views exist in practice to account for this transaction:

    (a) **View A.** IFRS 3 applies. The transaction is considered to be in substance a reverse acquisition (on the basis of paragraph B19 of IFRS 3). Any aggregate of the consideration transferred and the amount of the identifiable net assets acquired is recognised as goodwill (paragraph 32 of IFRS 3).

    (b) **View B.** IFRS 2 *Share-based Payment* applies. The transaction is considered to be in substance a share-based payment transaction (on the basis of paragraph 5 of IFRS 2) in which Entity B receives cash and services such as a ‘share listing’ from Entity A. Any excess between the consideration ‘received’ by Entity B and the consideration ‘paid’ by Entity A represents unidentified goods or services received that should be recognised as an expense in accordance with paragraph 13A of IFRS 2.

(c) **View C.** Proponents of this view assert that the transaction is neither a business combination nor a share-based payment. Consequently, management shall develop and apply an accounting policy in accordance with paragraphs 10 to 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. For instance, an entity could apply by analogy the consensus reached by the SEC staff in the US, in its Staff New Release 2001-FAQ, whereby the transaction is considered to be in substance a capital transaction rather than a business combination. That is, the transaction is equivalent to an issue of shares by the non-listed entity for the net monetary assets of the shell corporation, accompanied by a recapitalisation. Any excess between the consideration received and the consideration given is considered to be a deduction to equity to the extent of the cash received; any costs in excess of the cash received should be charged to expense.

16. The submitter requests the Interpretations Committee to add this issue to its agenda because:

(a) SPAC transactions are common in the business world as a mechanism to raise capital and go public; and

(b) significant diversity in practice exists regarding the accounting treatment for such transactions.

Second submission

17. The second submission (included in Appendix C) refers to the case of a dormant listed company ('Entity A1') that acquires 100 per cent of the share capital and voting rights of a non-listed contract staffing company ('Entity B1') by Entity A1 issuing shares to Entity B's shareholders.

18. The board of directors of Entity A1 is formed by an independent trust company. The submitter states that Entity A1 has net assets but does not specify its type.

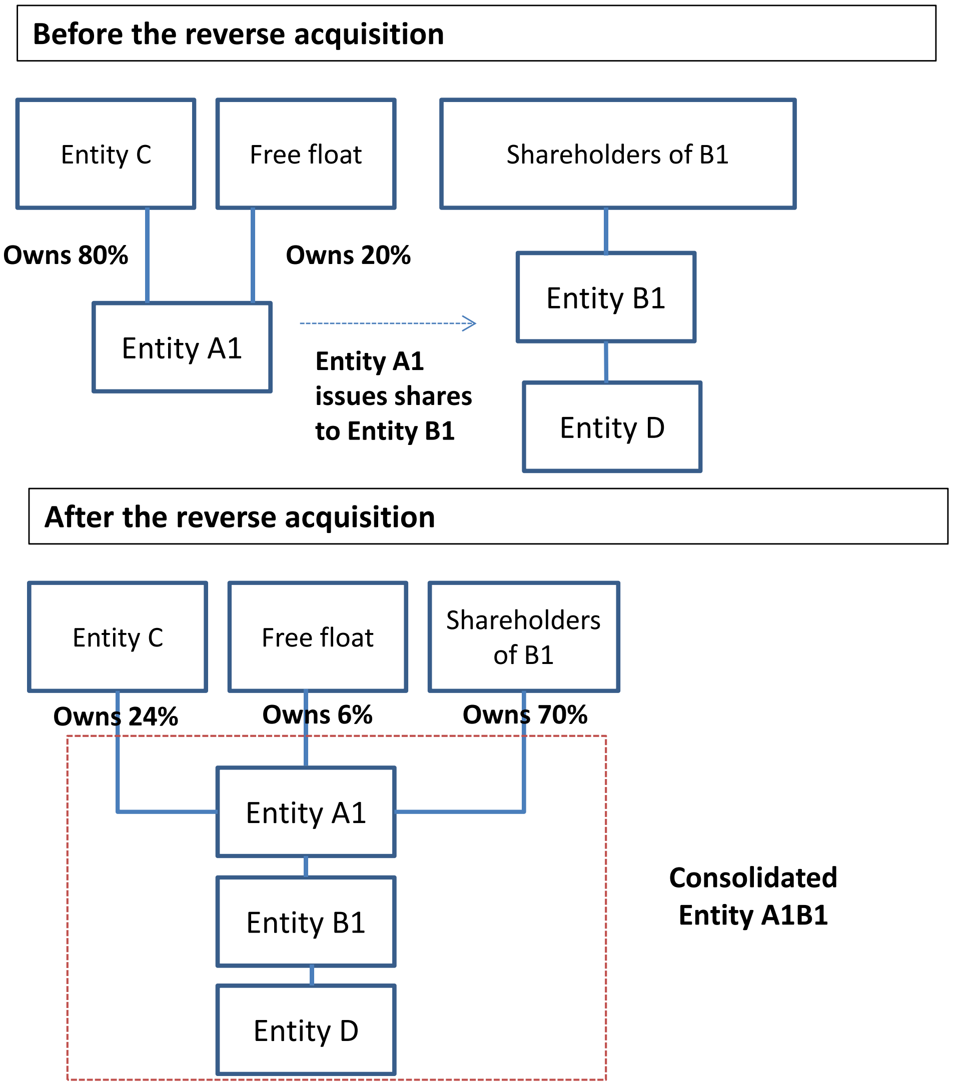
19. The objective of this transaction is for Entity B1 to obtain the listing status of the issuer (Entity A1).

20. After the transaction, the previous shareholders of Entity A1 and the shareholders of Entity B1 have the following ownership interest in the consolidated entity (hereafter referred to as 'Entity A1B1'[1]):

(a) the previous shareholders of Entity A1 (Entity C and 'Free float') retain only 30 per cent of the shares of Entity A1B1; and

(b) the shareholders of Entity B1 own 70 per cent of the shares of Entity A1B1 and have control of the consolidated entity.

21. The following diagram illustrates the **second fact pattern** submitted:


Before the reverse acquisition
Entity C
Free float
Shareholders of B1
Owns 80%
Owns 20%
Entity B1
Entity A1
Entity A1 issues shares to Entity B1
Entity D
After the reverse acquisition
Entity C
Free float
Shareholders of B1
Owns 24%
Owns 6%
Owns 70%
Entity A1
Entity B1
Entity D
Consolidated Entity A1B1

[1] In the fact pattern submitted Entity B1 has a subsidiary (ie 'Entity D) that in accordance with IFRS 10 *Consolidated Financial Statements* would also be consolidated. However, for simplification purposes, we have just referred to the consolidated group as 'Consolidated Entity A1B1'.

22. The submitter reports that Entity A1 developed an accounting policy to account for this transaction, based on IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.* This is because Entity A1 observed that IFRSs do not explicitly provide the accounting treatment of this particular type of transaction. The submitter also noted that:

    (a) in accordance with paragraph B19 of IFRS 3, the accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition; however, Entity A1 is not a business, because it is dormant; and

    (b) paragraph 5 of IFRS 2 excludes transactions in which an entity acquires goods as part of the net assets acquired in a business combination.

23. In its analysis Entity A1 judged that it could not be considered the acquirer in this transaction because:

    (a) the relative size of Entity B1 is significantly greater than that of Entity A1; and

    (b) the former management of Entity B1 manages the operating activities of the consolidated entity (Entity A1B1).

24. In the development of its accounting policy, Entity A1 judged that the substance of the transaction is a share-based-payment transaction whereby Entity B1 is deemed to have issued shares in exchange for the net assets of Entity A1 together with the listing status of Entity A1. Consequently, it applied by analogy:

    (a) IFRS 2 in determining the value of the deemed shares issued and the accounting for the net assets and listing status received; and

    (b) IFRS 3 in identifying Entity B1 as the accounting acquirer in this transaction.

25. The submitter thinks that the accounting policy developed by Entity A1 is reasonable but requests the Interpretations Committee to provide clear guidance on the accounting for similar transactions.

Staff analysis

26. We have identified the following relevant questions in our analysis of both of the fact patterns submitted. We will provide our analysis of these questions in subsequent paragraphs.

27. In the fact patterns analysed:

    (a) **Question 1**. Who is the acquirer in the transactions analysed?

        (i) Is Entity A (the shell company in the first fact pattern) and Entity A1 (the dormant company in the second fact pattern) purchasing Entity B/B1, respectively?; or

        (ii) is Entity B (the non-listed operating entity in the first fact pattern) and Entity B1 (the non-listed contract staffing company in the second fact pattern) purchasing Entity A/A1, respectively?

    (b) **Question 2**. Does Entity A/A1 constitute a business (as defined in paragraph B7 of IFRS 3)?

    (c) **Question 3.** How should the transactions be accounted for?

Question 1: Who is the acquirer in the transactions analysed?

28. We observe that in both fact patterns:

    (a) Entity A (in the first fact pattern) and Entity A1 (in the second fact pattern) are the *legal acquirers* because they issue equity interests; whereas

    (b) Entity B (in the first fact pattern) and Entity B1 (in the second fact pattern) are the *legal acquirees* because their equity interests are acquired by Entity A/A1, respectively.

29. However, we think that in both fact patterns, Entity B/B1 can be identified as the acquirer for accounting purposes. This is because after the combination takes place, the former shareholders of Entity B/B1 hold the majority voting interest in

the combined/consolidated entity, which gives them the power and ability to direct the combined entity's activities.

30. The power to direct is an indication of the ability to control the combined entity in accordance with paragraph 6 of IFRS 10. This paragraph states that (emphasis added):

> **An investor controls an investee** when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through **its power over the investee**.

31. In accordance with paragraph B9 of IFRS 10 (emphasis added):

> **To have power over an investee, an investor must have existing rights that give it the current ability to direct the relevant activities.** For the purpose of assessing power, only substantive rights and rights that are not protective shall be considered (see paragraphs B22–B28).

32. The existence of control is a circumstance that determines who the acquirer in accordance with paragraph B13 of IFRS 3, which states that (emphasis added):

> The guidance in IFRS 10 *Consolidated Financial Statements* shall be used to identify the acquirer—**the entity that obtains control of the acquiree.** If a business combination has occurred but applying the guidance in IFRS 10 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–B18 shall be considered in making that determination.

33. We also observe that in both fact patterns, the size of the legal acquiree (Entity B/B1) is greater than that of the legal acquirer (Entity A/A1) , which, in accordance with paragraph B16 of IFRS 3, could be seen as another indication that Entity B/B1, respectively, are the accounting acquirers in the transactions described. Paragraph B16 states that:

> The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit)

> is significantly greater than that of the other combining entity or entities.

34. Consequently, we think that:

    (a) in the first fact pattern analysed, the non-listed operating entity (Entity B, 'the legal acquiree') can be considered the *accounting acquirer* of Entity A; and

    (b) in the second fact pattern analysed, the non-listed contract staffing company ('Entity B1', 'the legal acquiree') can also be considered to be the *accounting acquirer* of Entity A1.

Question 2: Does Entity A/A1 constitute a business?

35. Appendix A of IFRS 3 defines a *business* as (emphasis added):

> **An integrated set of activities and assets** that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

36. Paragraph B7 of IFRS 3 defines a *business* as follows (emphasis added):

> **A business consists of inputs and processes applied to those inputs that have the ability to create outputs.** Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business.
>
> The three elements of a business are defined as follows:
>
> **(a) Input: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it**. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.

> **(b) Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs.** Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)
>
> (c) **Output: The result of inputs and processes applied to those inputs** that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

37. We think that in the first fact pattern, the elements acquired by Entity B are only inputs and no processes have been applied to those inputs to create outputs.

38. The inputs acquired by Entity B are:

    (a) cash; and

    (b) a listing status.

39. We think that no processes are applied to those inputs, because we observe that Entity A's activities are limited to managing cash balances and fulfilling obligations, and it has no operations.

40. In the second fact pattern, Entity A1 is described as a 'dormant public company' with net assets, which we interpret as being an entity that does not have significant accounting transactions or financial activity[2]. Similarly as for the first fact pattern, we think that the elements acquired by Entity B1 in the second fact

[2] The submitter does not provide further detail on the *net assets* owned by the 'dormant company'. Our limited research on 'dormant companies' indicated that the *net assets* normally owned by these companies may consist mainly of the amount of share capital paid when this entity was first formed and the few costs that the company might have incurred to remain registered.

pattern are only inputs and that no processes have been applied to those inputs to create outputs.

41. The inputs acquired by Entity B1 are:

(a) net assets; and

(b) a listing status.

42. On the basis of the above, we can conclude that in the fact patterns analysed, neither the shell company (in the first fact pattern) nor the dormant company (in the second fact pattern) constitutes a business.

43. If the inputs acquired by the accounting acquirer do not constitute a business, then the transaction cannot be considered a reverse acquisition, as stated in paragraph B19 of IFRS 3. An extract of this paragraph is presented below:

> **The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition**, and all of the recognition and measurement principles in this IFRS, including the requirement to recognise goodwill, apply.

The nature of the 'listing status' received

44. We have identified three different approaches on the nature of the 'listing status' acquired by Entity B/Entity B1 in both fact patterns, as follows:

(a) **View A.** It is an intangible asset.

(b) **View B.** It is a service acquired.

(c) **View C.** It is a transaction cost.

View A–Intangible asset

45. Proponents of this view think that the 'acquired listing status' meets the definition of an intangible asset in accordance with paragraphs 8–17 of IAS 38 *Intangible Assets*. Paragraph 10 states that (emphasis added):

> **Not all the items described in paragraph 9 meet the definition of an intangible asset, ie identifiability, control over a resource and existence of future**

> **economic benefits.** If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred. However, if the item is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date (see paragraph 68).

46. Paragraph 12 of IAS 38 further states that (emphasis added):

> An asset is identifiable if it either:
>
> (a) **is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged,** either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; **or**
>
> (b) **arises from contractual or other legal rights,** regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

47. Proponents of this view think that Entity B/B1 has acquired a right to issue shares to the public and that right is:

    (a) identifiable (ie because the right to issue shares to the public arises from a legal acquisition); and

    (b) controllable, because it has the power to receive future economic benefits derived from its listing status. The future economic benefits from this right may include, among others, the possibility of raising capital from the public and with this, an increase in its market share.

48. They think that without that specific right they will not be permitted to issue shares to the public.

49. As a consequence, proponents of this view think that the 'acquired listing status' would be reflected as an intangible asset and measured initially at cost, in accordance with paragraph 24 of IAS 38.

View B–Expense

50. Proponents of this view would apply the guidance in paragraph 13A of IFRS 2 to explain the nature of the 'acquired listing status'. This argument is consistent with the view that because the accounting acquiree is not a business in both fact patterns, there is no business combination and IFRS 2 applies to transactions that are not business combinations as explained in paragraph 5 (emphasis added):

> As noted in paragraph 2, this IFRS applies to share-based payment transactions in which an entity acquires or receives goods or services. Goods includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. **However, an entity shall not apply this IFRS to transactions in which the entity acquires goods as part of the net assets acquired in a business combination as defined by IFRS 3 *Business Combinations* (as revised in 2008),** in a combination of entities or businesses under common control as described in paragraphs B1–B4 of IFRS 3, or the contribution of a business on the formation of a joint venture as defined by IFRS 11 *Joint Arrangements*.

51. In line with the guidance in paragraph 13A of IFRS 2, they think that that any excess, resulting from the fair value of the shares that Entity B is deemed to have issued to Entity A and the amount of net assets acquired from Entity A, represents an unidentifiable service that Entity B has received. Paragraph 13A of IFRS 2 explicitly states that:

> **In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity**. The entity shall measure the identifiable goods or services received in accordance with this IFRS. **The entity shall measure the unidentifiable goods or services received (or to be**

> **received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received).** The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

52. In accordance with paragraphs 8–9 of IFRS 2, the unidentifiable service would be recognised as an expense (consumed) immediately at the moment that the counterparty renders the service. An extract from paragraph 8 and 9 is shown below (emphasis added):

> Paragraph 8
>
> When the goods or services received or acquired in a share-based payment transaction **do not qualify for recognition as assets, they shall be recognised as expenses.**
>
> Paragraph 9
>
> **Typically, an expense arises from the consumption of goods or services. For example, services are typically consumed immediately, in which case an expense is recognised as the counterparty renders service.** Goods might be consumed over a period of time or, in the case of inventories, sold at a later date, in which case an expense is recognised when the goods are consumed or sold.

View C–Transaction costs of an equity transaction

53. Proponents of this view think that the 'acquired listing status' represents a transaction cost (listing cost) that Entity B is deemed to have incurred in connection with its deemed issue of its own equity instruments to obtain its listing status.

54. Paragraph 37 of IAS 32 *Financial Instruments: Presentation*, provides the following description of transaction costs (emphasis added):

> **An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties.** The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.

55. In accordance with paragraph 35 of IAS 32, costs of "issuing or acquiring" equity are recognised as transaction costs of an equity transaction, recognised as a cost of issuing equity instruments, and treated as a deduction from equity. This paragraph states that:

> Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity, net of any related income tax benefit. **Transaction costs of an equity transaction shall be accounted for as a deduction from equity, net of any related income tax benefit**.

Our view

56. We do not support View A. We think that the 'acquired listing status' does not meet the definition of an intangible asset, because we think that it is not identifiable (within the context of paragraph 12 of IAS 38). This is because in our view the right to issue shares to the public:

(a) is not a right capable of being separated or divided from the entity and transferred (ie sold, licensed, exchanged or rented) either individually or together with a related contract, identifiable asset or liability; and

(b) is not a right specified in a legal contract derived from the legal acquisition of Entity B by Entity A (as the legal acquirer).

57. We support View B. We agree with the view that Entity B/B1 is acquiring a service (ie obtaining a listing status) from another entity (Entity A/A1), and is deemed to have issued shares, under a share-based payment arrangement, in exchange for the service received by Entity A/A1. However, we disagree that the service obtained from Entity A/A1 could be called “unidentifiable”. We think that the excess deemed to have been paid by Entity B/B1 could be identified as a service (a ‘listing status’) that Entity A/A1 is providing to Entity B/B1.

58. We give some merit to View C but ultimately we disagree with this view.

59. If Entity B/B1 is the accounting acquirer in the transactions described, the ‘acquired listing status’ might well represent an incremental cost of ‘issuing or acquiring” its own equity instruments. Consequently we can see how a “listing status” could be considered a transaction cost that can be directly attributable to the deemed equity transaction of Entity B/B1.

60. However, we think that this approach would reflect the view that the transaction is in substance, a capital transaction where Entity B/B1 obtains a recapitalisation (ie a change of its capital structure) and we disagree with this view. As we have mentioned, the objective of the transactions described is for Entity B/B1 to acquire a listing status. In our view, the excess deemed to have been paid by Entity B/B1 represents in substance a service that the accounting acquirer is deemed to have paid to obtain a listing status.

61. Consequently, we think that the inputs acquired by the accounting acquirer are services from the accounting acquiree and not transaction costs that Entity B/B1 has incurred.

Question 3. How should the transactions be accounted for?

62. In the previous sections we have identified the following aspects of the transactions described in both fact patterns:

(a) Entity B/B1 (the legal acquirees) can be identified as the acquirer for accounting purposes.

(b) Entity B/B1 has acquired from Entity A/A1, respectively, only inputs (net assets and a listing status) and no processes have been applied to those inputs. We have concluded that for this reason Entity A/A1 does not constitute a business.

(c) The 'acquired listing status' represents a service that Entity B/B1 has received from Entity A/A1, respectively.

63. We have noted that the transactions described in the fact pattern cannot be considered to be reverse acquisitions in accordance with paragraph B19 in IFRS 3, and accounted for as a business combination, because the accounting acquiree is not a business. Moreover, IFRS 3 does not specify how a reverse acquisition should be accounted for when the accounting acquiree is not a business.

64. We think that to account for the transactions described in the fact pattern, an entity would need to develop an accounting policy based on the guidance in IFRS 2 and based on the guidance in IFRS 3 which would be applied by analogy in line with paragraphs 10–11 of IAS 8. In doing so, management should apply all the aspects of these IFRSs that are relevant to the transactions analysed.

65. We think that management can look at:

(a) IFRS 3 because the transaction has many features of a reverse acquisition; and

(b) IFRS 2 to identify the substance of the fact patterns analysed.

66. We think that IFRS 3 provides relevant guidance on the identification of the accounting acquirer and on the measurement of the consideration transferred by the equity instruments granted by the non-public entity, which is not an aspect specifically covered by IFRS 2.

67. We observe that the transaction described in the fact pattern corresponds to the example included in the description of a reverse acquisition in paragraph B19 of IFRS 3. This paragraph states that (emphasis added):

> A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in paragraphs B13–B18. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. **For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity.** In this example, the public entity is the legal acquirer because it issued its equity interests, and the private entity is the legal acquiree because its equity interests were acquired.

68. Consequently, on the basis of the guidance provided in paragraph B7 and B19 of IFRS 3, Entity B/B1 can be identified as the *accounting acquirers.*

69. On the basis of the definition of a share-based payment in Appendix A of IFRS 2, we can determine that in substance, Entity B/B1 (as the accounting acquirers) has undertaken a share-based payment transaction with Entity A/A1, respectively, with the objective of acquiring a **service** (ie obtaining a listing status) from Entity A/A1, respectively.

70. We have observed that the transaction analysed in both fact patterns is not a business combination, so IFRS 2 can be applied based on paragraph 5 of that Standard. We have stated that in substance Entity B/B1 is receiving a service from Entity A/A1, respectively; and consequently we think that this transaction is included within the scope of IFRS 2.

71. In exchange for the cash and services received, the accounting acquirer in both transactions issues equity instruments. In accordance with paragraph 10 of IFRS 2 for equity-settled share-based payment transactions, the accounting acquirer will measure the services received, either directly **at the fair value of the**

goods or services received, or indirectly, by reference to the fair value of the equity instruments granted. In this respect, paragraph 10 states that:

> For equity-settled share-based payment transactions, **the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received**, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, **indirectly, by reference to the fair value of the equity instruments granted**.

72. Paragraph 13 of IFRS 2 presumes that for transactions with non-employees, the fair value of goods and services received is more readily determinable. However according to this same paragraph in some cases this presumption could be rebutted. This paragraph states that (emphasis added):

> To apply the requirements of paragraph 10 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the entity obtains the goods or the counterparty renders service. **In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service**.

73. In our view, the fair value of the listing status is not readily determinable, which would suggest that the corresponding increase in equity should be measured, instead, by reference to the fair value of the equity instruments granted at the date the counterparty renders the service.

74. In measuring the fair value of the equity instruments granted, we think that management would apply by analogy the guidance in paragraph B20 of IFRS 3 to measure the consideration transferred. The deemed issue of shares would be based on the number of equity interests that the accounting acquirer would have had to issue to the owners of the legal parent (the shell entity/the dormant company) so that they would have the same percentage of equity interests in the combined entity that would result from a reverse acquisition. Paragraph B20 of IFRS 3 states that (emphasis added):

> In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. **Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer.** Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree **is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition.** The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

75. The fair value of the equity instruments granted by the accounting acquirer would be determined based on the guidance in paragraphs B1–B41 of IFRS 2.

76. If the fair value of the equity instruments granted by the accounting acquirer exceeds the amount of the identifiable net assets received, we think that to account for this excess, management should apply the guidance in paragraph 13A of IFRS 2, which states the following (emphasis added):

> **In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has**

> **been (or will be) received by the entity**. The entity shall measure the identifiable goods or services received in accordance with this IFRS. **The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received).** The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

77. We think that IFRS 2 gives the best answer when accounting for the excess identified between the consideration received and transferred, because we think than in substance, the non-public operating entity is paying a 'premium' to obtain the listing status and that this payment for this 'service' should be recognised as an expense as soon as it is incurred, in accordance with paragraphs 8 and 9 of IFRS 2 (refer to paragraph 52 of this paper, above).

78. In summary, we think that the accounting treatment for the transactions described in the fact patterns would be as follows:

    (a) the assets and liabilities of Entity B/B1 (the accounting acquirers) are recognised and measured in the consolidated financial statements at their pre-combination carrying amounts.

    (b) the identifiable net assets of Entity A/A1 (the legal acquirers) received by Entity B/B1 (eg cash) are recognised in accordance with paragraph 10 of IFRS 2 at their fair value at grant date.

    (c) as the total identifiable consideration received by Entity B/B1 appears to be less than the fair value of the deemed equity given as consideration (determined by reference to the fair value of the equity instruments that are deemed to be issued by Entity B/B1), this situation indicates that other consideration has been received. The difference between the fair value of the share-based payment and the fair value of identifiable goods or services received is considered an unidentifiable service in accordance with paragraph 13A of IFRS 2 that should be recognised as an expense in profit or loss in accordance with paragraphs 8–9 of IFRS 2.

79. We have included a numerical example in **Appendix A** to illustrate our findings.

Assessment

80. We have assessed the issues addressed in the two submissions received against:

(a) the agenda criteria of the Interpretations Committee; and

(b) the annual improvements criteria.

Assessment against agenda criteria

81. Our assessment against the agenda criteria is as follows:

(a) The issue is widespread and has practical relevance.

(b) The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).

(c) Financial reporting would be improved through the elimination of the diverse reporting methods.

(d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.

(e) It is probable that the Interpretations Committee will be able to reach a consensus on the issue on a timely basis.

(f) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?

82. We think that:

(a) the issue is widespread and has practical relevance; and

(b) different views exist in practice to account for the transaction.

Annual Improvements criteria assessment

83. We assessed the issues analysed as a potential amendment to IFRS 3 to clarify the accounting for a reverse acquisition transaction where the accounting acquiree is not a business.

Annual improvements criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirements should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	(a) Yes. A proposed amendment would clarify the application of paragraph B19 of IFRS 3 in circumstances in which the accounting acquiree is not a business.
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	(b) Yes. The proposed amendments would be well defined and sufficiently narrow in scope that the consequences of the proposed change would have been considered. It contributes to consistent accounting for the transactions analysed.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) Yes. We think that the IASB will reach a conclusion on this issue on a timely basis.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	(d) Yes, because there is no current project on IFRS 3.

Staff recommendation

84. From our analysis we determined that IFRS 3 does not give specific guidance on accounting for transactions in which the accounting acquiree is not a business. We then concluded that the guidance in IFRS 2 and some of the guidance in IFRS 3 would be applicable to account for the transactions analysed.

85. We observe that the transactions analysed are narrow and limited to specific circumstances. However we think that general guidance could be developed to state how the existing guidance on business combinations in IFRS 3 and on share-based payments in IFRS 2 would be applied in circumstances in which the accounting acquiree does not meet the definition of a business.

Project options

86. We note that there are two different alternatives by which we could provide guidance to account for the transactions analysed. In our view additional guidance could be developed, either in the form of:

    (a) an annual improvement to IFRS 3; or

    (b) an Interpretation.

An annual improvement to IFRS 3

87. An amendment to IFRS 3 could provide a clarification to the guidance for reverse acquisitions in paragraph B19 of IFRS 3. More specifically, this clarification could contain a description on how to account for reverse acquisitions **in which the accounting acquiree is not a business.** In our view, some of the main aspects in this clarification would be:

    (a) that when the accounting acquiree is not a business, the transaction is not considered a reverse acquisition and should be considered, instead, to be a share-based payment transaction that would be accounted for in accordance with IFRS 2;

    (b) that the recognition and measurement principles in IFRS 2 would apply to account for this transaction; and

(c) in addition, the following aspects from IFRS 3 that are not specifically covered by IFRS 2 would apply:

(i) the identification of the accounting acquirer in paragraph 6 of IFRS 3 (and with this, the application guidance in paragraphs B7 and B13–B19 of IFRS 3); and

(ii) the measurement of the consideration transferred (in which case it should apply paragraph B20 of IFRS 3).

An Interpretation

88. Interpretations are designed to explain the requirements in other standards in a specific context by giving the background, scope, issues, consensus, application guidance (if appropriate), a basis for conclusions and (if appropriate) illustrative examples.

89. We think that the transactions analysed could qualify for the development of an interpretation, because the issues can be resolved within the confines of existing IFRSs (ie IFRS 3 and IFRS 2) and the Conceptual Framework, and the demands of the interpretation process (see paragraph 25(d) of the Due Process Handbook for the IFRS Interpretations Committee (updated December 2010).

90. This Interpretation would explain the interaction between IFRS 3 and IFRS 2 to account for the transaction analysed (as explained in the first option above).

Most appropriate approach

91. We would like to hear the Interpretations Committee’s views on the preferred approach to clarify the accounting treatment for the transactions analysed.

92. Our preference would be for the first option (propose an annual improvement) because we think that the guidance in paragraph B19 could be subject to further clarification.

Questions to the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis of the transactions?
2. Does the Interpretations Committee agree with the staff recommendation that the accounting for the transactions analysed could be further clarified? If so, does the Interpretations Committee think that this clarification should be addressed through an annual improvement or through anInterpretation?
2. Does the Interpretations Committee agree with the main aspects that will be included in this clarification, which are highlighted in paragraph 87 of this paper?

Appendix A—Numerical example

Entity S is a publicly listed ‘cash shell’ (ie an entity with a public listing but with no ongoing activities). Entity S has 100,000 ordinary shares in issue and CU180,000[3] in cash. **Entity B** is an entity with ongoing activities but that has not got a public listing (ie it is a private entity).

Entity S merges with Entity B by issuing shares to the shareholders of Entity B. The purpose of this agreement is for Entity B to obtain a fast-track listing status. Entity S issues 400,000 ordinary shares in exchange for all the ordinary share capital of Entity B (which has 80,000 ordinary shares).

After the combination, the shareholders of Entity B own 80 per cent (400,000 shares /500,000 total shares) of the combined entity and the original shareholders of Entity S own 20 per cent (100,000 shares/500,000 total shares) of the combined entity (Entity AB).

How should the transaction be accounted for?

Solution:

To account for this transaction, an entity would need to develop an accounting policy based on the guidance in IFRS 2 and based on the guidance in IFRS 3 which would be applied by analogy (in line with paragraphs 10–11 of IAS 8).

IFRS 3 (2008) limits business combinations to circumstances in which the acquiree is a business. Paragraph B19(b) clarifies that for reverse acquisitions, “the accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition”.

On the basis of the guidance in paragraph B13 of IFRS 3, Entity B is identified as the accounting acquirer in the transaction because it is the entity that obtains control of the combined entity.

The substance of the transaction, based on the guidance in IFRS 2, is that Entity B has agreed on an equity-settled share-based payment transaction with Entity S, whereby Entity B has received cash and a service from Entity S (its listing status) as consideration for its own equity instruments.

Paragraph 10 of IFRS 2 is applied to account for this transaction. The cash received in the transaction is recognised at fair value. The fair value of the listing status cannot be estimated reliably. Consequently, the listing status is measured indirectly, by reference to the fair value

[3] In this paper, currency amounts are denominated in ‘currency units’ (CU).

of the equity instruments that are (deemed to be) issued by Entity B to Entity S, on the basis of paragraph 13 of IFRS 2.

The determination of the fair value of the equity instruments deemed to be issued by Entity B to Entity S is based on the guidance in paragraph B20 of IFRS 3. In accordance with this paragraph, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests Entity B would have had to issue to give the owners of Entity S the same percentage equity interest in the combined entity that results from the reverse acquisition.

On the basis of the guidance in paragraph B20 of IFRS 3, Entity B would have had to issue 20,000 shares to Entity S to maintain the same ratio of ownership interest in the combined entity. In other words, Entity B would own 80 per cent of the total shares of the combined entity (80,000 shares/100,000 total shares) and the original shareholders of Entity S would own 20 per cent (20,000 shares/100,000 total shares) of the combined entity (Entity SB).

The fair value at grant date of the shares deemed to be issued by Entity B is determined using the guidance in Appendix B of paragraphs B1–B41 of IFRS 2. Entity B has no quoted market price for the value of the deemed shares issued. Nevertheless it applies the guidance in paragraphs B27–B30 for unlisted entities and considers the share price of similar listed entities. In this way it determines that the fair value at grant date of an Entity B share is CU12.

Consequently, the amount of consideration transferred is calculated as the amount of shares deemed to be issued by Entity B multiplied by their fair value at grant date (20,000 shares x CU12 = CU 240,000).

The cash received in the transaction is recognised at fair value. The value of the listing status does not qualify for recognition as an intangible asset and is, instead, considered a service received and is recognised in accordance with paragraph 13A of IFRS 2 as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received. Consequently, it is measured as the difference between the fair value of the equity instruments that are (deemed to be) issued by Entity B to Entity S and the fair value of the cash received (CU240,000–180,000) = CU60,000. This difference (the ‘listing status’) is recognised as an expense in profit or loss in accordance with the guidance in paragraph 13A of IFRS 2.

The accounting for the share-based payment transaction would be as follows:

Dr. Cash received	CU180,000	
Dr. Share listing expense	CU 60,000	
Cr. Equity issued		CU240,000

Appendix B—Submission received (KASB)

IFRSs relating to SPAC transactions

B1 We are reproducing in this Appendix the request that we have received from the Korean Accounting Standards Board's (KASB). All information has been copied without modification.

29 May 2012
Wayne Upton
Chair
IFRS Interpretations Committee
30 Cannon Street
London, EC4M 6XH

Re : Korean Accounting Standards Board's (KASB) technical inquiry about IFRSs relating to SPAC transactions

Dear Chair Wayne Upton:

On behalf of the KASB, I am writing this letter to ask for clarified guidelines on IFRSs relating to special purpose acquisition company (SPAC) merger transactions.

I greatly appreciate the efforts of the IFRS Interpretations Committee to reach out to diverse constituents around the globe and reflect their opinions in the IFRS standards. In this letter, I would like to draw your attention to issues relating to SPAC and propose that the IFRS IC consider the issues in its discussion.

A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the lack of clarity in IFRSs relating to such SPAC mergers resulted in diversity in practice.

Therefore, I would like to ask the IFRS IC to provide clear guidelines for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

I appreciate your consideration in advance, and it would be my pleasure to further discuss any aspects of this letter.

Please do not hesitate to contact me if you have any questions or comments about my inquiry. You may direct your inquiries either to me (suklim@kasb.or.kr) or to Woung-hee Lee (leewh@kasb.or.kr), Technical Manager of KASB.

Yours sincerely,
Suk-Sig (Steve) Lim
Chair, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Research Fellow of Research Department

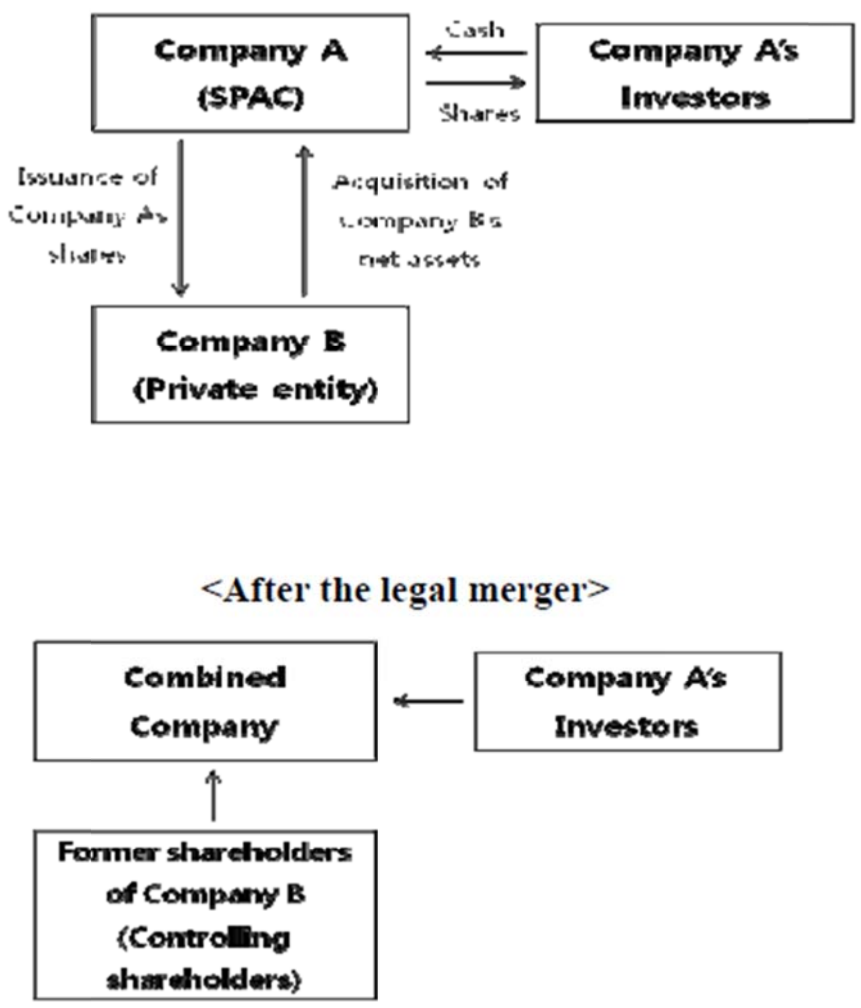
We are pleased to provide the IFRS Interpretations Committee with this technical inquiry about IFRSs regarding SPAC mergers. We finalized the technical inquiry through the due process established in the KASB.

Background

1. SPAC stands for Special Purpose Acquisition Company which is a public shell company whose purpose of establishment is to go public through an IPO and legally merge with a private entity.

2. The structure of a SPAC merger in legal form is as shown in Diagram 1 below.

Diagram 1



<Typical SPAC merger in legal form >
Company A (SPAC)
Cash
Shares
Company A's Investors
Issuance of Company A's shares
Acquisition of company B's net assets
Company B (Private entity)
<After the legal merger>
Combined Company
Company A's Investors
Former shareholders of Company B (Controlling shareholders)

3. With regard to the accounting treatment of a legal SPAC merger, the following issues are identified.

Issues

4. Company A is a SPAC and thus a public shell company, and Entity B is a private entity.

> 4.1 Company A merges with Entity B by issuing its shares to the shareholders of Entity B. Any and all management of Company A (a SPAC is usually a one-person company) retires upon the merger and Company A fulfils its sole purpose of business stated in its articles of association upon the transaction.
> 4.2 After the legal merger, the shareholders of Entity B own 90% of the combined company and the shareholders of Company A own 10%.

5. IFRSs do not explicitly provide the accounting treatment of this particular type of legal mergers.

> 5.1 In this case, the SPAC merger transaction is in substance a reverse acquisition due to the facts described in paragraphs 4.1 and 4.2. Consequently, Entity B becomes the accounting acquirer. However, since Company A, the accounting acquiree, does not meet the definition of a business as defined in paragraph 3 of IFRS 3 'Business Combinations', IFRS 3 may not be applied to this transaction according to paragraph 2 of the same standard.
>
> 5.2 Although applying IFRS 2 'Share-based Payment' to the transaction may be considered since Company A issues shares in the legal form, IFRS 3 should be applied, not IFRS 2, because Company A acquires Entity B (which meets the definition of a business) in return for the shares Company A issues. In such a case, however, one would have to go back to face the problem already described in paragraph 5.1 above (i.e., the transaction being a reverse acquisition and Company A, the accounting acquiree, not meeting the definition of a business).

6. This problem described in paragraph 5 above created a loop of going back and forth between the standards, and consequently resulted in diversity in practice regarding SPAC mergers.

Diversity in practice

7. After the legal merger, Entity B is to account for the transaction. Consider an example where the shares of the combined company owned by the shareholders of Company A are worth $20mil at fair value and Company A's net assets are worth $15mil at fair value. There exist three different views relating to the accounting treatment of such a case.

<View 1: It is a share-based payment transaction - charge $5mil to expense (IFRS 2 – PWC, E&Y Manual)>

8. According to paragraph 2 of IFRS 3, IFRS 3 'does not apply to the acquisition of an asset or a group of assets that does not constitute a business.' Company A, the accounting acquiree, is a public shell company (SPAC) whose sole purpose of establishment is to acquire another company. Such SPAC's business will be terminated after the merger. Thus, Company A does not meet the definition of a business specified in paragraph 3 of IFRS 3.

9. Therefore, since IFRS 3 does not apply to the above transaction and there are no other IFRSs with clear requirements for such transactions, management shall develop and apply an accounting policy themselves in accordance with paragraphs 10 to 12 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

10. In this case of the transaction given above, it may be viewed that Entity B (private entity) receives cash and services such as 'share listing' from Company A (SPAC) and in return issues its shares to the shareholders of the SPAC, i.e., Company A. This transaction could be interpreted as a share-based payment transaction and thus $5mil representing unidentified goods or services received may be recognized as expense in accordance with paragraph 8 and 13A of IFRS 2.

11. That is, View 1 perceives the economic substance of the transaction as a private entity receiving services and acquiring net assets from a SPAC to become listed and in return issuing shares as a consideration.

12. This view is based on the premise that IFRS 3 is not applied to this transaction because Company A does not meet the definition of a business as defined in IFRS 3. Even though reverse acquisition is a concept exclusively specified in IFRS 3, in this view where Entity B (private entity) is perceived as the issuer of shares according to IFRS 2, only the reverse acquisition concept is selected from IFRS 3 by analogy and applied together with IFRS 2. This, however, lacks proper logic. (refer to paragraph 5.1 above)

13. Furthermore, according to the defined terms and paragraph 11 of IFRS 2, Entity B shall measure the fair value of the shares at grant date. The date could be interpreted as approval date by meeting of shareholders when the merger arrangement is subject to an approval process by shareholders. In this case, the period of time between the date of merger arrangement and the date of approval would typically be four to five months in Korea. This could result in greater volatility in stock prices and a considerable amount of expenses recognized.

<View 2: It is an IPO for raising capital – reduction of $5mil to equity (US-GAAP, SEC Staff New Release 2001-FAQ)>

14. Although there is no clarified accounting standard for this type of SPAC transactions in the U.S., SEC Staff New Release 2001-FAQ interpreted that any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell corporation shall be recognized as a reduction to equity.

15. SEC Staff New Release 2001-FAQ may be applied according to paragraph 12 of IAS 8, and thus $5mil, the difference between the fair value of Entity B's shares ($20mil) and fair value of Company A's net assets ($15mil), may be charged to equity.

16. That is, View 2 perceives the economic substance of this transaction as Entity B raising capital from investors (the shareholders of Company A) using the merger transaction with a public shell company (SPAC). This is to view the transaction as one similar to a regular IPO performed by Entity B to

raise capital from investors.

<*View 3: A SPAC meets the definition of a business - recognize $5mil as goodwill (IFRS 3)*>

17. In the above transaction, Company A is a business listed for the purpose of acquiring another company, and thus it may be viewed as a public entity operating in accordance with its articles of association. Therefore, the SPAC merger transaction may be viewed as a reverse acquisition, fulfilling the requirements specified in paragraph B6(4) of IFRS 3. Thus, IFRS 3 may be applied to this transaction and $5mil, the difference between the fair value of Entity B's shares ($20mil) and fair value of Company A's net assets ($15mil), may be recognized as goodwill.

Question

18. As described herein, there is no IFRS that can be clearly and specifically applied to a SPAC related legal merger transaction and there is diversity in practice regarding this issue such as the above three views.

Against the background, which of the three views provided herein do you see as the most appropriate accounting treatment for a SPAC related merger?

Suggestion for improvement

19. A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the conflicting interpretations supported by Big 4 accounting firms and US-GAAP with respect to SPAC related mergers, i.e., charging any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell company to 'expense' (Big 4 accounting firms) or to 'equity' (US-GAAP), are causing more confusion in practice.

20. Therefore, the IFRS Interpretations Committee should provide clear guidelines for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

Supplement

21. In an effort to collect evidence of diversity in practice, the KASB requested members of the International Forum of Accounting Standard Setters (IFASS) to provide information on how they treat this particular type of SPAC merger transactions discussed in this paper in their own jurisdictions. The information provided by the members is as follows:

Country	Accounting treatment for SPAC mergers	Based on	Remarks
A	Accounting Policy Choice	IFRS	Recognizes diversity in practice.
B	Charge to expense (View 1)	IFRS	SPAC transactions are extremely rare due to legal and taxation related restrictions.
C	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	View 3 (recognizing goodwill) could be possible but View 2 (charging to equity) is least likely to be supported.
D	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	Auditors usually support View 1 but there were few cases where View 3 is applied.
E	Recognize goodwill (View 3)	IFRS	Premised on the assumption that the SPAC is an accounting acquirer.
F	Charge to expense (View 1)	Local GAAP	Local GAAP is almost identical to IFRS.
G	Recognize goodwill (View 3)	Local GAAP	Local GAAP is substantially different from IFRS.

Appendix

22. The KASB has submitted a suggestion for improvement regarding this issue of SPAC merger accounting to the IASB and is attached hereto as Appendix A for your reference. Furthermore, the related accounting standards discussed in this paper are attached as Appendix B for your reference.

Appendix A to the KASB's submission

29 May 2012

Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH

Re : KASB's suggestion for improvement of IFRSs relating to SPAC transactions

Dear Chair Hans Hoogervorst:

On behalf of the KASB, I am writing this letter to ask for clarification of IFRSs relating to special purpose acquisition company (SPAC) merger transactions.

I greatly appreciate the efforts of the IASB to reach out to diverse constituents around the globe and reflect their opinions in the IFRS standards. In this letter, I would like to draw your attention to issues relating to SPAC and propose that the IASB consider the issues in its discussion.

A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the lack of clarity in IFRSs relating to such SPAC mergers resulted in diversity in practice.

Therefore, I would like to ask the IASB to provide clear standards for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

I appreciate your consideration in advance, and it would be my pleasure to further discuss any aspects of this letter.

Please do not hesitate to contact me if you have any inquiries regarding my suggestion. You may direct your inquiries either to me (suklim@kasb.or.kr) or to Woung-hee Lee (leewh@kasb.or.kr), Technical Manager of KASB.

Yours sincerely,
Suk-Sig (Steve) Lim
Chair, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Research Fellow of Research Department

We are pleased to provide the IASB with this suggestion for improvement of IFRSs regarding SPAC mergers. We finalized the suggestion through the due process established in the KASB.

Issue

1. SPAC stands for Special Purpose Acquisition Company (represented as 'Company A' hereinafter) which is a public shell company whose purpose of establishment is to go public through an IPO and legally merge with a private entity (represented as 'Entity B' hereinafter).

2. Company A (SPAC) merges with Entity B (private entity) by issuing its shares to the shareholders of Entity B. Company A's sole business operation of finding and merging with a private entity is terminated after the merger.

3. However, there is no IFRS that can be clearly and specifically applied to a SPAC related merger transaction such as the above example.

Diversity in practice

4. The lack of clarity in IFRS relating to such SPAC mergers resulted in diversity in practice. The following are three different views about the accounting treatment of SPAC mergers.

<View 1: Share-based payment (IFRS 2 – PWC, E&Y Manual)>

5. According to paragraph 2 of IFRS 3 'Business Combinations', IFRS 3 'does not apply to the acquisition of an asset or a group of assets that does not constitute a business.' Company A, the accounting acquiree, is a public shell company (SPAC) whose sole purpose of establishment is to acquire another company, the accounting acquirer. Such SPAC's business will be terminated after the merger. Thus, Company A does not meet the definition of a business specified in paragraph 3 of IFRS 3.

6. Therefore, since IFRS 3 does not apply to the above transaction and there are no other IFRSs with clear requirements for such transactions, management shall develop and apply an accounting policy themselves in accordance with paragraphs 10 to 12 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

7. In this case of the transaction given above, it may be viewed that Entity B (private entity) receives cash and services such as 'share listing' from Company A (SPAC) and in return issues its shares to the shareholders of the SPAC, i.e., Company A. This transaction could be interpreted as a share-based payment transaction and thus IFRS 2 'Share-based Payment' is applied.

8. That is, View 1 perceives the economic substance of the transaction as a private entity receiving services and acquiring net assets from a SPAC to become listed and in return issuing shares as a consideration.

9. This view is based on the premise that IFRS 3 is not applied to this transaction because Company A does not meet the definition of a business as defined in

IFRS 3. Even though reverse acquisition is a concept exclusively specified in IFRS 3, in this view where Entity B (private entity) is perceived as the issuer of shares according to IFRS 2, only the reverse acquisition concept is selected from IFRS 3 by analogy and applied together with IFRS 2. This, however, lacks proper logic.

10. Furthermore, according to the defined terms and paragraph 11 of IFRS 2, Entity B shall measure the fair value of the shares at grant date. The date could be interpreted as approval date by meeting of shareholders when the merger arrangement is subject to an approval process by shareholders. In this case, the period of time between the date of merger arrangement and the date of approval would typically be four to five months in Korea. This could result in greater volatility in stock prices and a considerable amount of expenses recognized.

<*View 2: Raising capital through an IPO (US-GAAP, SEC Staff New Release 2001-FAQ)*>

11. Although there is no clarified accounting standard for this type of SPAC transactions in the U.S., SEC Staff New Release 2001-FAQ interpreted that any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell corporation shall be recognized as a reduction to equity.

12. SEC Staff New Release 2001-FAQ may be applied according to paragraph 12 of IAS 8, and thus the difference between the fair value of Entity B’s shares and fair value of Company A’s net assets may be charged to equity.

13. That is, View 2 perceives the economic substance of this transaction as Entity B raising capital from investors (the shareholders of Company A) using the merger transaction with a public shell company (SPAC). This is to view the transaction as one similar to a regular IPO performed by Entity B to raise capital from investors.

<*View 3: Business combination (IFRS 3)*>

14. In the above transaction, Company A is a business listed for the purpose of acquiring another company, and thus it may be viewed as a public entity operating in accordance with its articles of association. Therefore, the SPAC merger transaction may be viewed as a reverse acquisition, fulfilling the requirements specified in paragraph B6(4) of IFRS 3. Thus, IFRS 3 may be applied to this transaction and the difference between the fair value of Company B’s shares and fair value of Company A’s net assets may be recognized as goodwill.

Suggestion for improvement

15. A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the conflicting interpretations supported by Big 4 accounting firms and US-GAAP with respect to SPAC related mergers, i.e., charging any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell company to ‘expense’ (Big 4 accounting firms)

or to ‘equity’ (US-GAAP), are causing more confusion in practice.

16. Therefore, the IASB should provide standards for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

Supplement

17. In an effort to collect evidence of diversity in practice, the KASB requested members of the International Forum of Accounting Standard Setters (IFASS) to provide information on how they treat this particular type of SPAC merger transactions discussed in this paper in their own jurisdictions. The information provided by the members is as follows:

Country	Accounting treatment for SPAC mergers	Based on	Remarks
A	Accounting Policy Choice	IFRS	Recognizes diversity in practice.
B	Charge to expense (View 1)	IFRS	SPAC transactions are extremely rare due to legal and taxation related restrictions.
C	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	View 3 (recognizing goodwill) could be possible but View 2 (charging to equity) is least likely to be supported.
D	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	Auditors usually support View 1 but there were few cases where View 3 is applied.
E	Recognize goodwill (View 3)	IFRS	Premised on the assumption that the SPAC is an accounting acquirer.
F	Charge to expense (View 1)	Local GAAP	Local GAAP is almost identical to IFRS.
G	Recognize goodwill (View 3)	Local GAAP	Local GAAP is substantially different from IFRS.

Appendix

18. The KASB has also submitted a technical inquiry about this issue of SPAC merger accounting to the IFRS Interpretations Committee. The inquiry submitted to the IC contains backgrounds and description of the issue in more detail and is attached hereto as Appendix A for your reference. Furthermore, the related accounting standards discussed in this paper are attached as Appendix B for your reference.

Appendix B to the KASB's submission: Related accounting standards

[IFRS 2]

8 When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.

13A In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with this IFRS. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

[IFRS 3]

SCOPE

2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:
(a) the formation of a joint venture.
(b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in IAS 38 Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.
(c) a combination of entities or businesses under common

Identifying a business combination

3 An entity shall determine whether a transaction or other event is a business combination by applying the definition in this IFRS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12 provide guidance on identifying a business combination and the definition of a business.

The acquisition method

4 An entity shall account for each business combination by applying the acquisition method.

Identifying the acquirer

6 For each business combination, one of the combining entities shall be identified as the acquirer.

7 The guidance in IAS 27 Consolidated and Separate Financial Statements shall be used to identify the acquirer—.the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in IAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–.B18 shall be considered in making that determination.
Identifying a business combination (application of paragraph 3)

B5 This IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:
(a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);
(b) by incurring liabilities;
(c) by issuing equity interests;
(d) by providing more than one type of consideration; or
(e) without transferring consideration, including by contract alone (see paragraph 43).

B6 A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:
(a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
(b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or
(d) a group of former owners of one of the combining entities obtains control of the combined entity.

Definition of a business (application of paragraph 3)

B7 A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:
(a) Input: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.
(b) Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)

(c) Output: The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

B8 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—.inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

B11 Determining whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

Identifying the acquirer (application of paragraphs 6 and 7)

B13 The guidance in IAS 27 Consolidated and Separate Financial Statements shall be used to identify the acquirer—he entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in IAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–18 shall be considered in making that determination.

B14 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called ‘reverse acquisitions’, the issuing entity is the acquiree. Paragraphs B19–27 provide guidance on accounting for reverse acquisitions. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

(a) the relative voting rights in the combined entity after the business combination—The acquirer is usually the combining entity whose owners as a group retain or IFRS 3 receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.
(b) the existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest—he acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.
(c) the composition of the governing body of the combined entity—he acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.
(d) the composition of the senior management of the combined entity—he acquirer is usually the combining entity whose (former) management dominates the

management of the combined entity.
(e) the terms of the exchange of equity interests—he acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

B16 The acquirer is usually the combining entity whose relative size (measured in, for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

B17 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Reverse acquisitions

B19 A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in paragraphs B13–18. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private IFRS 3 entity is the legal acquiree because its equity interests were acquired. However, application of the guidance in paragraphs B13–18 results in identifying:

(a) the public entity as the acquiree for accounting purposes (the accounting acquiree); and
(b) the private entity as the acquirer for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this IFRS, including the requirement to recognise goodwill, apply.

Measuring the consideration transferred

B20 In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

[PwC A Global Guide to Accounting for Business Combinations and Non Controlling Interests]

2.10.1 Reverse Merger Involving a Nonoperating Public Shell and a Private Operating Entity

The merger of a private operating entity into a nonoperating public shell corporation with nominal net assets typically results in (i) the owners of the private entity gaining control over the combined entity after the transaction, and (ii) the shareholders of the former public shell corporation continuing only as passive investors. This transaction is usually not considered a business combination, because the accounting acquiree, the nonoperating public shell corporation, does not meet the definition of a business under the Standards. Instead, these types of transactions are considered to be capital transactions of the legal acquiree and are the equivalent to the issuance of shares by the private entity for the net monetary assets of the public shell corporation, accompanied by a recapitalisation.

Under U.S. GAAP, any excess of the fair value of the shares issued by the private entity over the value of the net monetary assets of the public shell corporation is recognised as a reduction to equity.

Under IFRS, such transactions fall within the scope of IFRS 2 and any excess of the fair value of the shares issued by the private entity over the value of the net monetary assets of the public shell corporation is recognised in profit or loss [IFRIC 8; IFRS 2].

[PwC Manual of Accounting IFRS 2011]

12.30 IFRS 3 states that if the accounting acquiree is not a business then it is not in the scope of IFRS 3. In some circumstances, for example for a reverse acquisition, it is not always clear whether a business has been acquired and, therefore, the substance of the arrangement should be considered. This is illustrated in the following example.

Example – Reverse acquisition into a shell company

Entity V, a listed entity that does not constitute a business at the time of the transaction, issues shares in exchange for shares in entity W. Although entity V becomes entity W's legal parent, the transaction is not a business combination under IFRS 3, because entity V is not a business and has not gained control over entity W in substance.

IFRS 2 scopes out transactions in which an entity acquires goods as part of the net assets acquired in a business combination as defined in IFRS 3.

We believe that the transaction is within IFRS 2's scope because the substance is that shareholders of private entity W have given shareholders of public entity V an interest in entity W in exchange for any assets sitting within entity V and entity V's listing. Accordingly, entity W should fair value the consideration that entity V's shareholders receive (the shares given out by entity W's shareholders) and the identifiable assets of entity V that entity W's shareholders acquired. Any resulting difference would be unidentifiable goods or services which should be expensed (unless it meets the definition of an asset under other standards). Appropriate disclosure to explain the accounting policy is necessary. See further chapter 25 for a more detailed example.

[EY International GAAP 2011]

3.2.5 Application of the definition of a business
In determining whether acquired assets and activities are a business, we believe the acquirer should first identify the elements acquired; that is, the inputs, processes and outputs. If outputs are not included in the acquired set, an assessment must be made as to whether the acquired activities and assets include inputs and processes that are capable of producing some form of return to its investors, owners, members or participants (the 'owners'). If some inputs and processes are omitted from the acquired activities and assets such that the acquired set is not capable of providing some form of return to its owners, the acquirer must assess whether the missing inputs and processes would preclude a market participant from operating the acquired activities to earn a return. If a market participant that, in many cases, would be a competitor of the acquirer, were to have the missing inputs or processes, or could easily replace or replicate the missing inputs and processes (i.e. the missing elements are minor), the acquired set is likely a business. However, if the acquired set has no processes (e.g. only assets, and no activities, were acquired), the acquired set in most cases would not constitute a business. All of the specific facts and circumstances must be considered in applying this highly subjective judgment.

The application of the above guidance to certain transactions in the extractive industries is illustrated in the following examples.

Example 9.3: Extractive industries – definition of a business (1)

E&P Co A (an oil and gas exploration and production company) acquires a mineral interest from E&P Co B, on which it intends to perform exploration activities to determine if reserves exist. The mineral interest is an unproven property and there have been no exploration activities performed on the property.

Inputs – mineral interest
Processes – none
Output – none
Conclusion

In this scenario, we do not believe E&P Co. A acquired a business. While E&P Co A acquired an input (mineral interest), it did not acquire any processes. Whether or not a market participant has the necessary processes in place to operate the input as a business is not relevant to the determination of whether the acquired set is a business because no processes were acquired from E&P Co B.

[SEC Staff New Release 2001 – FAQ]

F. Reverse Acquisitions -- Accounting Issues

APB No. 16, paragraph 70 states that ‘presumptive evidence of the acquiring corporation in combinations effected by an exchange of stock is obtained by identifying the former common stockholder interests of a combining company which either retain or receive the larger portion of the voting rights in the combined corporation. That corporation should be treated as the acquirer unless other evidence clearly indicates that another corporation is the acquirer...’ SAB Topic 2A affirms the above principle and discusses some of the factors which may rebut the normal presumption.

In December 1989, the Emerging Issues Committee of the Canadian Institute of Chartered Accountants reached a consensus concerning Reverse Takeover Accounting, which is compatible with the guidance included in Topic 2A. The EIC consensus indicates that the post reverse-acquisition comparative historical financial statements furnished for the ‘legal acquirer’ should be those of the ‘legal acquiree’ (i.e., the ‘accounting acquirer’), with appropriate footnote disclosure concerning the change in the capital structure effected at the acquisition date. Ordinarily, the guidance of APB 16 is applied in the allocation of the purchase price to all of the assets and liabilities of the accounting acquiree. (The staff believes the ‘partial stepup’ methodology of EITF 90-13 applies only in the particular facts and circumstances specified in that consensus.)

The merger of a private operating company into a non-operating public shell corporation with nominal net assets typically results in the owners and management of the private company having actual or effective operating control of the combined company after the transaction, with shareholders of the former public shell continuing only as passive investors. These transactions are considered by the staff to be capital transactions in substance, rather than business combinations. That is, the transaction is equivalent to the issuance of stock by the private company for the net monetary assets of the shell corporation, accompanied by a recapitalization. The accounting is identical to that resulting from a reverse acquisition, except that no goodwill or other intangible should be recorded.

Transaction costs (e.g., legal and investment banking fees, stock issuance fees, etc.) may be incurred in a reverse acquisition. In the merger of two operating companies, those costs will be, depending on their nature, either part of the purchase consideration that is allocated to the net assets of the acquired business, charged directly to equity as a reduction from the fair value assigned to shares issued, or expenses of the period. In contrast, an operating company's reverse acquisition with a nonoperating company having some cash has been viewed by the staff as the issuance of equity by the accounting acquirer for the cash of the shell company.

Accordingly, we believe transaction costs may be charged directly to equity only to the extent of the cash received, while all costs in excess of cash received should be charged to expense.

Appendix C – Submission received (ESMA)

Agenda item request reverse acquisition

C1 We are reproducing in this Appendix the request that we have received from the European Securities and Markets Authority (ESMA). All information has been copied without modification.

24 July 2012
ESMA/2012/464

IFRS IC

Wayne Upton

Cannon Street 30
London, EC4M 6XH
United Kingdom

Agenda item request reverse acquisition

Dear Mr Upton,

The effective and consistent application of European Securities and Markets legislation is important for ESMA. In the area of financial reporting this is mainly achieved through ESMA's European Enforcers Co-ordination Sessions (EECS), a forum in which all European national enforcers of International Financial Reporting Standards (IFRS) meet to exchange views and discuss experience with enforcement of IFRS.

As a result of the review of the financial statements carried out by national competent authorities and ESMA's co-ordination activities there is an issue related to IFRS 2 – *Share-Based Payment* and IFRS 3 – *Business Combinations*, which we would like to bring to the attention of the IFRS Interpretations Committee.

A detailed description of the case is set out in the appendix to this letter.

We would be happy to further discuss these issues with you.

Yours sincerely,

Steven Maijoor
ESMA Chair
Julie Galbo
Chair ESMA's Corporate Reporting Standing Committee

APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

Description of the transaction

1. The issuer is a dormant public company with 5 million issued ordinary shares. The board of directors is formed by an independent trust company. Entity B is a private contract staffing company.

2. At the date of the transaction, the issuer has net assets of 1 million CU.

3. During the year, the issuer and entity B entered into an agreement in which the issuer acquired 100% of the share capital and voting rights of entity B. In return the issuer issues 11,9 million shares to shareholders of entity B. The purpose of this transaction was for entity B to obtain a stock ex-change listing.

Ownership structure

4. The ownership interests in the issuer before and after the transaction are as follows:

	Before	After
Shareholders of B	0%	70%
Entity C	80%	24%
Free float	20%	6%

Governing body after the transaction

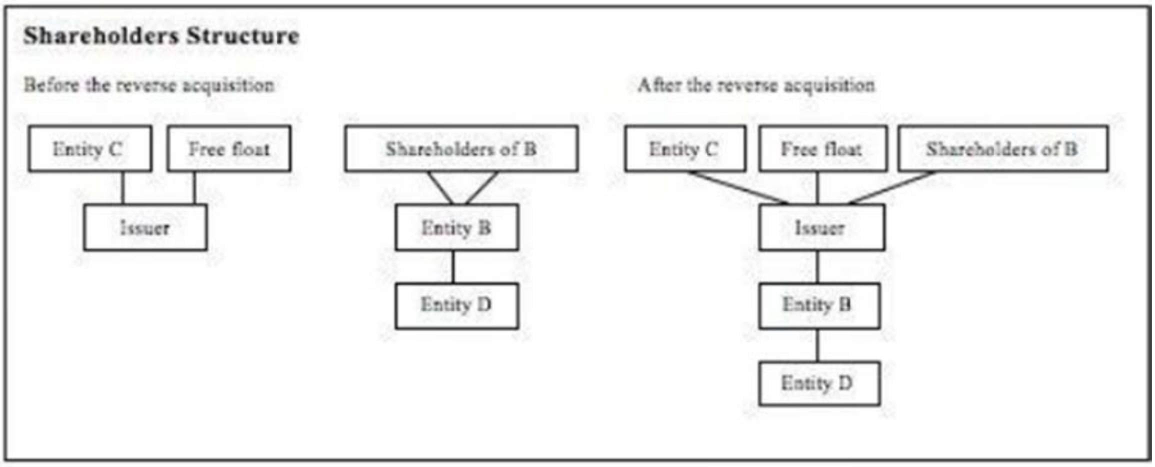
5. As the shareholders of entity B have 70% of the votes after the transaction they have the ability to appoint or remove a majority of the members of the governing body of the combined entity.

Senior management after the transaction

6. The issuer's board of directors did not change after the transaction and is still composed by the trust company. The operating management of the issuer is composed of the management of entity B be-fore the transaction.

Relative sizes of companies

7. The relative size of entity B is significantly greater than of the issuer when comparing the assets, revenues and net profit.


Shareholders Structure
Before the reverse acquisition
After the reverse acquisition
Entity C
Free float
Issuer
Shareholders of B
Entity B
Entity D
Entity C
Free float
Shareholders of B
Issuer
Entity B
Entity D

Accounting treatment in the Issuers' financial statements

8. The issuer recorded the transaction in its IFRS financial statements as a share-based payment trans-action, whereby entity B is deemed to have issued shares in exchange for the net assets of the issuer together with the listing status of the issuer.

9. In the notes to the IFRS consolidated financial statements the issuer describes that those statements are a continuation of the financial statements of entity B. Furthermore, the legal capital is adjusted and reflects the legal capital of the Issuer.

10. First the issuer considered the application of IFRS 2 and IFRS 3 to the transaction:

(a) Considering the details of the transaction, according to IFRS 3, the transaction should be ac-counted as a reverse acquisition. However the acquiree (the issuer) does not comprise a busi-ness. Taking into account IFRS 3 paragraph B19, the transaction is not falling under the scope of IFRS 3;

(b) According to IFRS 2 paragraph 5 an entity shall not apply IFRS 2 to transactions in which the entity acquires goods as part of the net assets acquired in a business combination as defined by IFRS 3. As the acquisition of entity B by the issuer is a business combination, IFRS 2 is not applicable to this transaction.

11. As a consequence of the above, and in line with the principle stated under IAS 8 paragraph 10, the issuer developed the following accounting policy to reflect the substance of the transaction in the financial statements:

(a) The previous shareholders of the issuer retain only 30% in the combined entity resulting from the transaction while the shareholders of entity B have 70% of the voting rights. Furthermore the former management of entity B manages the operating activities and entity B is signifi-cantly greater than the issuer. Treating the issuer as the acquirer in such circumstances would place the form of the transaction over its substance;

(b) As entity B is in substance the continuing entity, the issuer identified entity B as the acquirer for accounting purposes. Therefore the issuer applied the principles and guidance of IFRS 3 to identify the acquirer and applied reverse acquisition accounting for this transaction;

(c) As entity B does not acquire a business the issuer applied the requirements of IFRS 2 to determine the value of the deemed shares issued and how to account for the net assets and listing status received.

Question

12. Even if the accounting policy developed by the issuer in this situation is reasonable and acceptable under current IFRSs, after considering both IFRS 3 and IFRS 2 requirements, we believe that IFRS is not providing clear guidance as these transactions seem to be excluded from the IFRS scope, and there is a risk that divergent applications may arise in practice.