STAFF PAPER

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IFRS Interpretations Committee Meeting

IFRS IC September 2012

Project	**Tentative agenda decision**
Paper topic	IFRS 3 *Business Combinations*: accounting for reverse acquisition transactions where the acquiree is not a business

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Introduction

1. At its September 2012 meeting, the IFRS Interpretations Committee (the Interpretations Committee) discussed two requests to provide guidance on how to account for two reverse acquisition transactions in which the accounting acquiree is not a business. These questions were submitted because IFRS 3 *Business Combinations* does not provide guidance for this case and, as a consequence, there is diversity in practice. The main analysis of this issue was included in Agenda Paper 15 of September 2012.

2. The Interpretations Committee decided that the accounting for the fact patterns analysed could be resolved efficiently within the confines of existing IFRSs and concluded that an interpretation or an amendment to IFRSs was not necessary. It requested the staff to draft a tentative agenda decision that would include the main issues addressed in this discussion for consideration at a future meeting.

3. A day before its September 2012 meeting, the Interpretations Committee received a letter from the Korea Accounting Standards Board (KASB) containing further comments on our analysis of accounting for reverse acquisition transactions in which the accounting acquiree is not a business. We included this as an addendum to Agenda Paper 15 (refer to: Agenda Paper 15 Addendum: additional comment letter received). This letter is included in **Appendix B**.

4. We subsequently asked the KASB to provide clarifications on some of these comments which are included. These clarifications are reproduced in **Appendices C–D** of this agenda paper.

Purpose of the paper

5. The main purpose of this paper is to present to the Interpretations Committee a draft of a tentative agenda decision about the accounting for reverse acquisition transactions in which the accounting acquiree is not a business, which was analysed at its September 2012 meeting. The main analysis of this issue is included in Agenda Paper 15 of September 2012.

6. This paper also analyses additional related issues that were raised via a comment letter from the KASB about the accounting for reverse acquisition transactions in which the accounting acquiree is not a business. This letter was included as an addendum to Agenda Paper 15 (refer to: Agenda Paper 15 Addendum: additional comment letter received). For ease of reference this letter is reproduced in **Appendix B** of this paper.

7. We asked the KASB to provide further clarification on some of its comments. For ease of reference those comments are reproduced in **Appendices C–D** of this paper.

8. Our proposal for a tentative agenda decision about the accounting for reverse acquisition transactions in which the accounting acquiree is not a business will consider:

   (a) the discussions that the Interpretations Committee had at its September 2012 meeting; and

   (b) the subsequent comments that we received from the KASB.

9. Our proposed tentative agenda decision is included in **Appendix A** of this paper.

Structure of the paper

10. This paper:

(a) provides background information;

(b) addresses the comments raised by the KASB on the agenda paper that we presented to the Interpretations Committee at its September 2012 meeting as well as the clarifications made on those comments;

(c) provides a draft of a tentative agenda decision for the consideration of the Interpretations Committee members, which is based on the discussions that they had at its September 2012 meeting and our views on this paper regarding the further issues raised by the KASB; and

(d) asks the Interpretations Committee whether it agrees with the draft of the tentative agenda decision.

Background information

11. In the fact pattern received from the first submitter, a special purpose acquisition company (SPAC) with no ongoing activities is created to obtain a public listing through an initial public offering.

12. The SPAC then acquires an existing non-listed operating entity (Entity B) and both entities merge to form one legal entity (Entity AB).

13. After the transaction, the former shareholders of Entity B gain control of Entity AB.

14. In the second fact pattern received from the second submitter, a dormant listed company (Entity A1) acquires 100 per cent of the share capital and voting rights of a non-listed contract staffing company (Entity B1) by issuing shares to Entity B's shareholders and create a consolidated entity (‘Entity A1B1’).

15. Entity A1 has net assets but the submission does not specify its type. The objective of this transaction is for Entity B1 to obtain the listing status of the issuer (Entity A1).

16. After the transaction, the shareholders of Entity B1 hold a majority of the shares of Entity A1B1 and have control of the consolidated entity.

17. The Interpretations Committee identified the following common aspects in both fact patterns:

    (a) the non-operating listed entity (the SPAC and/or dormant entity) does not constitute a business;

    (b) the merged/combined entity retains the non-operating entity's listing;

    (c) the former shareholders of the operating entity become the majority shareholders of the merged/combined entity; and

    (d) there is a difference between the consideration received from the accounting acquiree and the consideration transferred by the accounting acquirer.

18. The Interpretations Committee analysed these two requests at its September 2012 meeting. A summary of the discussion was reported in the September 2012 *IFRIC Update*. This summary is reproduced below (emphasis added):

> The Interpretations Committee tentatively observed that a reverse acquisition transaction, with such fact patterns as described above in which the accounting acquiree is not a business, **is a share-based payment transaction that would be accounted for in accordance with IFRS 2 *Share-based Payment*.** This is because the non-listed operating entity (in both fact patterns) has issued shares in return for obtaining a service (ie a listing) from the non-operating entity. The Interpretations Committee also tentatively observed that **in the two fact patterns examined the legal acquirer would be identified and accounted for as the accounting acquiree in accordance with paragraphs B19–B27 of IFRS 3 for reverse acquisitions**. This guidance would be applied by analogy in accordance with paragraphs 10– 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
>
> The Interpretations Committee tentatively noted that, **in applying the guidance in B19–B27 of IFRS 3, the**

consideration transferred by the accounting acquirer would be based on the number of equity interests that the non-listed operating entity would have had to issue to give the listed entity the same percentage equity interest in the combined entity that results from a reverse acquisition.

The Interpretations Committee further tentatively noted that **the difference between the amount of the consideration transferred and the identifiable assets acquired (ie cash and/or other net assets that do not constitute a business) would be recognised as an expense, representing the cost of the service received (the listing)**. In addition, some Interpretations Committee members observed that in some jurisdictions, companies would identify within this amount incremental transaction costs directly attributable to the issue of equity instruments. Transaction costs of an equity transaction are accounted for as a deduction from equity, in accordance with IAS 32 *Financial Instruments: Presentation*.

Comments raised by the KASB

19. A day before the September 2012 meeting with the Interpretations Committee we received a comment letter from the KASB providing some additional views on the staff paper presented to the Interpretations Committee at that meeting. This letter was included as an addendum to Agenda Paper 15 (refer to: Agenda Paper 15 Addendum: additional comment letter received). For ease of reference this letter is reproduced in **Appendix B** of this paper.

20. We asked the KASB to further clarify some of the views included in this letter. We received a couple of replies from KASB with clarifications of its views. These clarifications are reproduced in **Appendix C** and **Appendix D** of this paper.

21. The KASB thinks that the purpose of the merger transaction in the fact pattern submitted is not only for the accounting acquirer to obtain a listing (but also for the accounting acquirer to raise capital).

22. Consequently, the KASB views the transaction as being, in substance, a capital transaction where a non-listed operating entity obtains not only a ‘listing status’ but also a ‘recapitalisation’. This is because the non-operating listed entity raised cash and through the reverse acquisition the operating entity gained access to the cash.

23. The KASB disagrees with the staff’s recommendation in Agenda Paper 15 of September 2012 that the excess between the consideration transferred and the consideration received should be expensed (in accordance with the guidance in IFRS 2). The KASB notes that recognising the ‘excess’ identified as an expense would be misleading, particularly in those cases where the ‘excess’ identified tends to be a substantial amount.

24. The KASB thinks that the ‘excess’ identified should be viewed additionally as a transaction cost incurred in raising capital that should be recognised as a reduction to equity[1]. The KASB observe that it had considered this view in its original submission. We are reproducing below ‘View 2’[2] which we extracted from paragraphs 14–16 of the KASB’s original submission (emphasis added):

> ***<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**

[1] This is because in accordance with KASB’s views: “if the merger between the SPAC and the non-listed operating entity has both purposes (ie obtaining a listing status and raising capital), the ‘excess’ identified should be expensed and should be deducted from equity, depending on the purpose”.

[2] We had reflected this view as “View C” in Agenda Paper 15 of September 2012.

> **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**.

25. To illustrate its views, the KASB provided us with examples of three non-listed operating entities in Korea (Company A, Company B and Company C) that are considered 'businesses' as defined in paragraph B7 of IFRS 3. Each one of these companies had merged with a listed non-operating entity that is not a business (ie a SPAC) with the purpose of raising capital and obtaining a listing.

26. After the merger took place, each one of these companies recognises an excess between the consideration received and the consideration transferred. From these entities, Company C recognised the highest excess between the consideration transferred and the consideration received.

27. The KASB observed that such considerable excess recognised by Company C could not be solely attributed to the payment of a listing from that company to the shell entity, but instead should be attributed to transaction costs incurred by Company C for raising capital and obtaining a listing.

28. We subsequently asked the KASB to explain the reason why the excess identified between the consideration received and the consideration transferred in the illustration for Company C was comparatively higher than for the other two entities (Company A and Company B).

29. The KASB replied explaining that for Company C the substantial excess identified between the consideration received and the consideration transferred arises as a consequence of the change in the share price from announcement date to the date of approval of the merger arrangement (grant date). The KASB explains that a period of 4 to 5 months passes between the announcement date and the date of approval of the merger arrangement (acquisition date).

30. During this lag time, the SPAC's share price tends to increase. The KASB explains that this is because "investors in the market will have a tendency to highly appreciate the stock price of the SPAC if the SPAC merges a profitable company, such as Company C."

31. In KASB's view the consideration transferred should be determined by applying the guidance in paragraphs IE1–IE5 of IFRS 3. This guidance illustrates the application of paragraphs B19–B27 of IFRS 3 in determining the fair value of the consideration transferred in a reverse acquisition.

32. The KASB observes that in line with paragraph IE5 of IFRS 3, the value of the consideration transferred by the non-listed operating entity (Company C) would be based on the fair value of the consideration transferred that provides the most reliable measure. Paragraph IE5 is reproduced below (emphasis added):

> IE5 **The fair value of the consideration effectively transferred should be based on the most reliable measure. In this example, the quoted price of Entity A's shares in the principal (or most advantageous) market for the shares provides a more reliable basis** for measuring the consideration effectively transferred than the fair value of the shares in Entity B, **and the consideration is measured using the market price of Entity A's shares—**100 shares with a fair value per share of CU16.

33. The KASB further notes that the fair value of the consideration transferred by the SPAC is more reliable than the fair value of the consideration transferred by Company C because Company C is not a listed entity and its shares are not

quoted. Consequently, the value of the consideration transferred is not determined based on the fair value of the consideration deemed to be transferred by Company C.

34. The KASB observes that the fair value of the consideration transferred is determined, instead, based on the number of shares issued by the SPAC multiplied by its market price. Because the SPAC is a listed company and a quoted market price exists for its shares, it provides a more reliable basis for measuring the consideration transferred.

35. The KASB has asked the Interpretations Committee to revisit its conclusion based on the facts described above.

Staff analysis

36. Noting the additional comments received from the KASB, we think we need to consider two further issues in our analysis of the fact pattern, as follows:

(a) **Issue 1.** Can the excess identified between the consideration transferred and the consideration received (that we had concluded was the cost paid by the non-listed entity to obtain a listing) be otherwise explained as a transaction cost or a cost of raising finance that is part of the fair value of the consideration exchanged between the SPAC and the non-listed entity (accounting acquirer)?

(b) **Issue 2.** Should the fair value of the consideration transferred at grant date be determined from the perspective of the SPAC or the non-listed operating entity?

Issue 1: Can the excess identified between the consideration transferred and the consideration received be explained as a transaction cost or a cost of raising finance?

Description of the costs incurred by the SPAC

37. We note that the SPAC incurs costs of:

(a) issuing **new** shares in an initial public offering (IPO) to raise cash;

(b) listing the **new** shares; and

(c) issuing further **new** shares in exchange for the shares of the non-listed operating entity such that the shareholders of non-listed entity gain control of the merged entity.

38. In our view

(a) the costs of issuing and listing new shares (described above in paragraph 38 (a) and (b)) would be considered pre-acquisition costs because these costs would typically be expected to be incurred some time prior to the reverse acquisition (possibly several months before); whereas

(b) the costs of issuing further new shares in exchange for the shares of the non-listed operating entity (described above in paragraph 38 (c))would be incurred as part of the reverse acquisition.

39. We think that the transactions described in paragraph 38 (a)–(c) are common transactions that the SPAC is expected to undertake, either prior to the reverse acquisition or at the time of the reverse acquisition.

40. We will consider the appropriate accounting treatment of these various transactions below.

Should the costs incurred by the SPAC be deducted from equity?

41. In accordance with paragraph 37 of IAS 32, transaction costs that an entity typically incurs **in issuing or acquiring its own equity instruments** are the following (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.**

42. Paragraph 9 of IAS 39 *Financial Instruments: Recognition and Measurement* defines transaction costs as follows (emphasis added):

> Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see Appendix A paragraph AG13). **An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.**

43. We observe that paragraph 37 of IAS 32 includes the following requirement (emphasis added):

> **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

44. Based on the guidance in paragraph 37 of IAS 32 (above) we think that only incremental costs that are directly related to the issuance of new equity instruments or the acquisition of an entity's own equity instruments are costs that can be deducted from equity.

45. In our view, the pre-acquisition costs incurred by the SPAC **in issuing new shares** (refer to paragraph 34(a), above) to raise capital represent transaction costs that the SPAC deducts from its equity at the time of issuing these shares.

46. We think that the pre-acquisition costs incurred by the SPAC (refer to paragraph 38(b), above) for **listing the new shares** issued would represent incremental costs directly attributable to the equity transaction if they directly relate to the issuance of <u>new</u> equity instruments. In our view if the SPAC had incurred transaction costs directly attributable to previously issued or existing shares, these costs would have been expensed and not deducted from equity.

47. We note the guidance in paragraph 38 of IAS 32 on transaction costs that relate jointly to **more than one transaction**, as follows (emphasis added):

> Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. **Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares)** are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.

48. We think that if the shares had been listed at the same time the shares were issued, then the listing costs incurred by the SPAC relate jointly to the same transaction and can be deducted from the SPAC's equity. We think that if the new shares had been issued but had been subsequently listed, the listing costs incurred would have been expensed and not deducted from equity

49. We think that the costs incurred by the SPAC in issuing **new shares in exchange** for the acquisition of the legal acquiree (refer to paragraph 38(c), above) can be considered a transaction cost for the SPAC and therefore deducted from its equity as these are costs that the SPAC incurred in issuing its own equity instruments.

50. In the following section we will analyse whether the excess paid by the operating non-listed entity can be attributed to the transaction costs incurred by the SPAC.

Views identified

51. We have identified the following views in determining whether the transaction costs incurred by the legal parent (ie the SPAC) could explain the excess identified between the consideration transferred and the consideration received in the merger transaction between the SPAC and the non-listed entity (accounting acquirer):

    (a) **<u>View 1:</u>** All transaction costs incurred by the legal parent e are transaction costs deemed to have been incurred by the accounting acquirer.

(b) **<u>View 2:</u>** Only the transaction costs incurred by the legal parent to acquire the non-listed operating entity are transaction costs deemed to have been incurred by the accounting acquirer.

(c) **<u>View 3:</u>** Transaction costs incurred by the legal parent C are separate and independent from the fair value exchange between the SPAC and the accounting acquirer.

View 1 – all transaction costs are deemed to have been incurred by the accounting acquirer

52. Proponents of this view think that the transaction costs incurred by the legal parent (ie to issue new shares to raise capital, to list the new shares issued and to issue additional new shares in exchange for the acquisition of the legal acquiree) are transaction costs that the non-listed operating entity was deemed to have incurred had it become a listed company without having to merge with the SPAC.

53. In the proponents' view the transaction costs incurred by the legal parent that are deducted from its equity are costs that it effectively undertook on behalf of the non-listed operating entity. Consequently, they think that the 'excess' (or a portion of this excess) between the consideration transferred and the consideration received could be attributed to the transaction costs incurred by the legal parent and explained as the transaction costs that the non-listed operating company was deemed to have incurred for issuing and listing shares.

54. Accordingly, proponents of this view think that the excess identified should be deducted from equity but only to the extent of the total transaction costs incurred by the SPAC; and any amount of the 'excess' that exceeds the transaction costs incurred would be expensed.

View 2 – a portion of the transaction costs are deemed to have been incurred by the accounting acquirer

55. Proponents of this view think that pre-acquisition costs incurred by the legal parent when issuing new shares to raise capital and the costs incurred to list these shares are not transaction costs that the non-operating listed entity was deemed to have incurred because they were incurred before the acquisition took place. .

56. However, proponents of this view think that the ‘excess’ (or a portion of this excess) between the consideration transferred and the consideration received could be attributed to the transaction costs incurred by the legal parent in issuing new shares in exchange for the acquisition of the legal acquiree because this is a transaction cost that the non-listed operating entity was deemed to have incurred as part of the reverse acquisition transaction.

57. Accordingly, proponents of this view think that the ‘excess’ identified should be deducted from equity only to the extent of the transaction costs incurred by the legal parent in the issue of new shares in exchange for the legal acquiree. Any amount in excess of the transaction costs incurred by the SPAC should be expensed including any portion of the ‘excess’ attributable to the cost of listing existing shares.

View 3 –transaction costs incurred by the SPAC is a separate transaction from the merger

58. Proponents of this view think that none of the transaction costs incurred by the legal parent (ie to issue new shares to raise capital, to list the new shares issued and to issue additional new shares in exchange for the acquisition of the legal acquiree) are part of the fair value exchange between the buyer and seller. In this respect they note the guidance in paragraph BC366 of IFRS 3 for the recognition of acquisition-related costs in a business combination, which is reproduced below (emphasis added):

> **The boards concluded that acquisition-related costs are not part of the fair value exchange between the buyer and seller for the business. Rather, they are separate transactions in which the buyer pays for the fair value of services received.** The boards also observed that those costs, whether for services performed by external parties or internal staff of the acquirer, do not generally represent assets of the acquirer at the acquisition date because the benefits obtained are consumed as the services are received.

59. Proponents of this view also observe that transaction costs incurred in connection with this issue of shares do not represent an incremental cost linked to the equity instruments of the accounting acquirer (ie the non-listed operating entity). This is because from a legal perspective it is the legal parent (and not the accounting acquirer) is the entity that effectively issues its own shares to acquire the non-listed operating entity.

60. In addition, proponents of this view observe that in accordance with paragraph B21–B22 of IFRS 3 the consolidated financial statements represent the continuation of the financial statements of the legal subsidiary (accounting acquirer) **except for** its capital structure, which reflects that of the legal parent (accounting acquiree). In accordance with paragraph B22 the equity structure in the consolidated financial statements are determined as follows (emphasis added):

> the amount recognised as issued equity interests in the consolidated financial statements determined by adding the issued equity interest of the legal subsidiary (the accounting acquirer) outstanding immediately before the business combination to the fair value of the legal parent (accounting acquiree). **However, the equity structure (ie the number and type of equity interests issued) reflects the equity structure of the legal parent (the accounting acquiree), including the equity interests the legal parent issued to effect the combination. Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse acquisition**.

61. Proponents of this view observe that the transaction costs incurred by the legal parent (either as a pre-acquisition costs of the merger transaction or as part of the reverse acquisition transaction) are already reflected in the legal parent’s capital structure as they have been recognised as a deduction in its equity. Consequently, in the view of these proponents, attributing the ‘excess’ (or a portion of this

excess) between the consideration transferred and the consideration received to the transaction costs incurred by the legal parent is not appropriate, because these transaction costs have already been deducted from equity.

62. Accordingly, their view is that the 'excess' identified should be fully expensed in accordance with paragraph 8 of IFRS 2.

Our view

63. We agree with View 3. We think that in analysing this transaction we should focus on the perspective of the accounting acquirer (although we also acknowledge that View 2 has a focus on the perspective of the accounting acquirer).

64. In our view the main purpose of the merger transaction is for the accounting acquirer to obtain a public listing by obtaining control of the SPAC.

65. We also observe that in practice, the accounting acquirer does not incur any transaction costs to obtain its listing and transaction costs are only incurred by the legal parent. Moreover, we think that the fact that the transaction is effected as a reverse acquisition does not provide a basis for past costs incurred by the legal parent to be recognised by the accounting acquiree.

66. In addition, because the transaction costs the legal parent incurs have been deducted from the legal parent's equity we do not think that the 'excess' (or a portion of this excess) between the consideration transferred and the consideration received could be attributed to the transaction costs deemed to be incurred by the accounting acquirer and deducted "again" from equity in the consolidated financial statements.

67. Consequently, we think that that the excess identified should be fully expensed. This expense represents the cost of the service paid by the non-listed operating entity in exchange for obtaining a public listing.

Issue 2: Measurement of the consideration transferred

68. We note that the KASB's view is to determine the consideration transferred based on the guidance in paragraphs IE1–IE5 of IFRS 3. This guidance illustrates the

application of paragraphs B19–B27 of IFRS 3 in determining the fair value of the consideration transferred in a reverse acquisition.

69. The Interpretations Committee has observed that the fact pattern analysed is <u>not</u> a reverse acquisition because the accounting acquiree is not a business and instead, it is in substance, a share-based payment transaction that would be accounted for in accordance with IFRS 2.

70. In accordance with the guidance in paragraphs 10–11 of IFRS 2 for equity-settled share-based payment transactions an entity shall measure the goods or services received, and the corresponding increase in equity, directly at the fair value of the goods and services received at the grant date. These goods and services are the net assets of the SPAC, plus the share listing "service". IFRS 2 also states that if fair value of the goods and services received cannot be estimated reliably, then the entity shall measure this value by reference to the fair value of the equity instruments granted.

71. In our view, the accounting acquirer in the fact pattern analysed shall measure the value of the consideration transferred by reference to the fair value of the equity instruments granted. This is because valuing the share listing "service" is unlikely to be possible (or reliable). Consequently, it is our view that the value of the public listing can be determined only by reference to the fair value of the equity instruments granted (this is, the value of the public listing will be determined as a residual between the cash received and the fair value of the equity instruments granted).

72. IFRS 2 does not specify who should grant the equity instruments (ie whether the legal acquirer or the accounting acquirer). The Interpretations Committee has observed, however, that in determining the fair value of the equity instruments granted, an entity would apply by analogy the guidance in paragraph B20 of IFRS 3 for reverse acquisitions. In accordance with this guidance, 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 (ie the non-listed operating entity) would have had to have issued to the owners of the legal parent (ie the listed non-operating entity) the same percentage equity interest in the combined entity that results from the reverse

acquisition. This would indicate that the value of the public listing can be determined by reference to the fair value of the deemed shares issued by the accounting acquirer.

73. Nevertheless, the guidance in paragraph IE5 of IFRS 3 states that the value of the consideration transferred should be based on the value that provides the most reliable measure. This means that this value would be based either on the fair value of the shares deemed to be issued by the accounting acquirer or on the fair value of the shares actually issued by the SPAC, depending on which is more reliably determinable.

74. In the fact pattern analysed the SPAC's quoted price is considered more reliable because in accordance with paragraph 78 of IFRS 13 *Fair Value Measurement*:

> **A quoted price in an active market provides the most reliable evidence of fair value** and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79.

75. Consequently, we agree that the calculation of the fair value of the consideration transferred, will be based on the fair value of the shares actually issued by the SPAC. This is, the fair value would be determined by multiplying the number of shares issued by the SPAC by its quoted market price, as shown in the guidance in paragraph IE5 of IFRS 3.

76. We, however, note the fact that the accounting acquirer is not a listed company would not prevent it from being able to calculate the fair value of the shares that are deemed to be issued in exchange for the SPAC's shares based on the guidance in paragraph B20 of IFRS 3 and paragraphs B1–B61 in Appendix B of IFRS 2.

77. In our view, not only the way the entity's shares are valued would tend to trigger a large 'excess' between the consideration transferred and received in a merger transaction. We think that the existence of a large 'excess' can also be explained by the date at which the fair value is determined.

78. In the fact pattern analysed we determined that in accordance with the guidance in paragraphs 10–11 of IFRS 2 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 and services received at the **grant date**, unless that fair value cannot be estimated reliably, in which case the entity shall measure this value by reference to the fair value of the equity instruments granted. IFRS 2 defines 'grant date' in Appendix B as follows (emphasis added):

> At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions if any, are met. **If that agreement is subject to an approval process (for, example, by shareholders), grant date is the date when that approval is obtained**.

79. In the fact pattern subsequently sent by the submitter (refer to Appendix D in this paper) we observe that the reason for a large 'excess' appears to be the movement in the share price between announcement date (1st January 20X1) and registration date (1st May 20X1). At 'registration date'[3] (which the submitter considered is the 'grant date' in this fact pattern), the share price has almost quadrupled from the value that the share price had at announcement date. Consequently, in our view, this increase is, by far, the most important factor in explaining the size of the excess between the consideration received and the consideration transferred in the fact pattern analysed.

Staff recommendation

80. Resulting from the staff analysis of the subsequent issues raised by the submitter, we recommend that the Interpretations Committee members reaffirm its conclusion of the fact pattern submitted by the KASB. In substance, the non-listed entity is receiving a service from the SPAC to obtain a public listing status.

81. Consequently, an entity would need to develop an accounting policy in accordance with the guidance in IFRS 2.

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[3] In the fact pattern submitted we were told that the merger agreement was resolved at an extraordinary shareholders meeting in 1st April 20X1. In our view 1st April 20X1 (and not 1st May 20X1) should be considered the *grant date* because this is the date when the approval is obtained. Determining the most appropriate *grant date* is not, however, the subject of the analysis in this paper.

82. We think that for identifying the acquirer and measuring the consideration transferred an entity would need to develop an accounting policy based on the guidance in IFRS 3. This Standard would be applied, by analogy, in line with paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Draft of tentative agenda decision

83. We have set out the wording for the tentative agenda decision in Appendix A of this paper.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis and the staff recommendation? 2. Does the Interpretations Committee agree with the wording for the tentative agenda decision shown in Appendix A?

Appendix A—Proposed tentative agenda decision

A1. We propose the following wording for the tentative agenda decision:

IFRS 3 *Business Combinations* and IFRS 2 *Share-based Payment*—Accounting for reverse acquisitions that do not constitute a business

The Interpretations Committee received two requests for guidance on how to account for reverse acquisition transactions in which the accounting acquiree is not a business. IFRS 3 *Business Combinations* does not provide guidance for reverse acquisitions in which the accounting acquiree is not a business and as a consequence there is diversity in practice.

The Interpretations Committee analysed two fact patterns in which a non-listed operating entity obtains a listing by combining with a listed non-operating entity. In achieving this, the listed non-operating entity acquires the entire share capital of the non-listed operating entity by issuing new shares in exchange for the shares of the non-listed operating entity. Subsequent to this transaction:

(a) the merged/consolidated entity retains the non-operating entity's listing;

(b) the former shareholders of the non-listed operating entity become the majority shareholders of the combined entity; and

(c) there is a difference between the value of the identifiable net assets of the accounting acquiree and the value of the consideration deemed to be transferred by the accounting acquirer.

The Interpretations Committee observed that the transaction has some features of a reverse acquisition and consequently, it is appropriate to apply by analogy, in accordance with paragraphs 10–12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* the guidance in paragraphs B19–B27 of IFRS 3 for reverse acquisitions. In accordance with this guidance the legal acquiree is identified as the accounting acquirer and the legal acquirer is identified as the accounting acquiree.

The Interpretations Committee also observed that based on the guidance in paragraph B7 of IFRS 3 the accounting acquiree is not a business. Because the accounting acquiree is not a business, the transaction would be considered a share-based payment transaction that would be accounted for in accordance with IFRS 2 *Share-based Payment*.

The Interpretations Committee noted that in applying the reverse acquisition guidance in paragraph B20 of IFRS 3 by analogy, the accounting acquirer is deemed to have issued shares to obtain control of the acquiree. Any difference in the fair value of the shares deemed to have been issued and the fair value of the acquiree's identifiable net assets, represents a service received by the accounting acquirer for the net assets of the accounting acquiree, that service being the listing of shares.

The Interpretations Committee further noted that the receipt of this service in exchange for the deemed issue of shares is a share-based payment, the value of which is recognised in profit or loss.

Based on the analysis above, the Interpretations Committee determined that in light of the existing IFRS requirements an interpretation or an amendment to IFRSs was not necessary and consequently [decided] not to add this issue to its agenda.

Appendix B—Comment letter received form KASB

B1 We are reproducing in this Appendix the comment letter we received by e-mail from the Korean Accounting Standards Board's (KASB). All information has been copied without modification.

17 September 2012

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

Additional comments on Agenda paper 15 of IFRS IC meeting in September

Dear Chair Wayne Upton:

On behalf of the KASB, I am writing this letter to comment on Agenda paper 15 'Accounting for reverse acquisition transactions where the acquiree is not a business' discussed at the IFRS IC meeting in September. The paper deals with our request to provide guidance to account for the transaction.

After analyzing the paper, we have found some points that were overlooked. It could be largely divided into the following two issues.

To begin with, the staff did not fully consider the reason for executing a SPAC merger transaction.

According to the staff paper, the staff believes that the nature of the transaction is to obtain a 'listing status' and thus it is a service acquired in accordance with IFRS 2 in substance ('View B'). On the other hand, the staff did not agree with the view ('View C') that the transaction is in substance a capital transaction where a non-listed operating entity obtains a recapitalization. Paragraph 60 in the paper states that:

> *'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.'*

However, there is no reasonable evidence to support View B in the paper, even though the SPAC merger transactions have both purposes to obtain a 'listing status' and raise 'capital'.

Therefore, we believe that the staff overlooked the objective of a SPAC merger transaction in relation to the perspective of a capital transaction without any considerations.

Furthermore, in the staff recommendation of this paper, the excess identified between the consideration received and transferred is recognized as 'expenses'. This does not reflect the economic substance, especially in our jurisdiction. Paragraph 13 in Appendix B in the paper states the reason as follows:

'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.

Below are the cases that occurred during 2011 in Korea.

<Unit: thousand of US dollars>

Cases	Company A	Company B	Company C
A. Net assets acquired (Consideration received)	18,923	23,800	19,916
B. Consideration Transferred (equity instruments fair value)	19,986	28,125	32,519
(A-B=C). The excess identified between the consideration received and transferred that was recognized as 'expenses'	(-) 1,063	(-) 4,325	(-)12,603
D. Net income	1,130	1,576	(-)3,115
(D-C) Net income excluding the excess amounts recognized as 'expenses'	2,193	5,901	9,488

The cases show that the stock price of the company which has a superior financial position and good profitability is highly appreciated in the market and thus if a SPAC merges a company similar to Company C, the amount of expenses recognized would increase. In the case of Company C, we do not believe that Company C paid USD 12,603,000 to obtain the status of listing. This would make the users of the financial statements of Company C confused. The reason is that even though Company C is a profitable company in substance, the users of the financial statements of Company C could misunderstand the financial position of Company C due to the large net loss which includes the recognized 'expenses' of the excess identified between the consideration received and transferred.

I appreciate your consideration in advance, and I hope it helps you and the staff member, Denise Durant, understand our concerns with respect to the agenda paper.

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

Appendix C—Further clarification points sent by the KASB

C1 We are reproducing in this Appendix further clarification points that we received by e-mail from the Korean Accounting Standards Board's (KASB). All information has been copied without modification.

Dear Durant Denise

I'm writing this-e-mail to reply your request below.

I grasped that you would like to know the reason the "Company C" described in the example had comparatively higher the excess identified between the consideration received and transferred that others.

I'll try to specifically explain the reason to enhance your understanding regarding the difference as follows:

Because this transaction has many features of a reverse acquisition, we can apply the guidance in paragraphs B19~B27 and IE1~IE5 in IFRS 3 to this transaction.
The consideration transferred from 'Company C' could be measured(or calculated) as the number of shares, according to the B20 in IFRS 3, multiply listed SPAC stock price, according to the IE5 in IFRS 3.

According to the IE 5 in IFRS 3, the fair value of the consideration transferred should be based on the most reliable measure and thus market's stock price of listed entity("SPAC" in our example) provides a more reliable basis for measuring the consideration transferred than the estimated fair value of unlisted entity("Company C" in our example).

Therefore, we used stock price of listed SPAC to calculate the fair value of the consideration transferred from Company C.

In our jurisdiction, the period of time between the date of merger arrangement and the date of approval would typically be four to five months.

I'm not certain whether the lag time is common all over the world or not.

Due to this lag time, the information that SPAC merges a profitable company, like "Company C", could be spread in the stock market and this result in the increase of SPAC stock price.

This is because the investors in the market will have a tendency to highly appreciate the stock price of the SPAC if SPAC merges a profitable company, such as 'Company C'

I show you the simplest example to explain the difference with ease.

> A SPAC concluded an agreement with Company C on 1 January 20X1 to merge with Company C which is a non-listed company.
>
> The rate of merger was determined in accordance with law at the time of concluding the agreement. The rate of merger between the SPAC and Company C is as follows:

- Share price of the listed SPAC: 1,000 KRW (the share price at the time of concluding the merger agreement; fair value of net assets at 10,000,000 KRW) -> This stock price is quoted market price.

* The share price of the SPAC at the time of concluding the agreement is almost the same as the fair value of the SPAC's net assets per share – this is so because most of the SPAC's assets are cash.

- Share price of Company C: 2,000 KRW (the share price determined according to law)
- Rate of merger: Issue 2 shares of the SPAC for every 1 share of Company C (After the merger, 10,000 shares of the total of 30,000 shares of the merged entity will be held by the SPAC and 20,000 shares by Company C according to the rate of merger.)

The merger agreement was resolved at an extraordinary shareholders meeting held on 1 April 20X1, and the merger was completed as of the registration date of merger of 1 May 20X1.

The accounting for merger is administered by Company C on 1 May 20X1 which is the registration date of merger – Company C accounts for the receipt of the assets and liabilities of the accounting acquiree, the SPAC.

Meanwhile, the share price of the SPAC on the registration date of merger increases to 4,000 KRW (This shows that the market views Company C to be a strong entity; this is also the result of stock price overshooting caused by the merger.)

Thus, the accounting treatment for merger on the registration date of merger in the combined entity's FS("Company C"'s F/S) is as follows:
Dr) Fair value of the SPAC's net assets 10,000,000
Cr) Consideration transferred (4,000 x 10,000 shares) 40,000,000
The excess identified between the consideration transferred and received: 30,000,000

As shown above, the increase of the SPAC's share price on the registration date of merger resulted in a large amount of excess between the consideration transferred and received.

Consequently, after merging with SPAC, a large amount of the excess identified between the consideration received and transferred could occur in the combined entity's F/S(Company C's F/S).

I hope this helps. If you have any further questions, please let me know.

Best regards,

Woung-hee, Lee

Technical Manager (KICPA, USCPA)
Korea Accounting Standards Board
Korea Accounting Institute

Appendix D—Further clarification points sent by the KASB

Dear Denise:

I think your questions are at the major points of this discussion.

In case of question 1, if the consideration transferred had been considered the stock price of the non-listed entity, the excess could be recognized, but it would be uncertain to know whether the excess is high or not.

The reason that, even though the stock price of the non-listed entity is determined according to law and regulation at the date of merger arrangement, that of the non-listed entity should be determined again according to IAS 39 or IFRS 13 at the merger date to conduct the merger accounting.

However, the users of F/S usually consider the quoted market stock price more reliable and the cost of measuring fair value of the non-listed entity could also be significant. Therefore, we believe that the paragraph IE5 in IFRS 3 could be analogized in determining the consideration transferred.

In case of question 2, if the consideration transferred had been considered the stock price of the listed entity at the date of merger arrangement, as you identified the example that I suggested, the excess could be considerably small.

Additionally, from my point of view, the large amount excess in "Company C" could be interpreted into "goodwill", because this goodwill mean the intangible value of the Company C, like future growth, that is evaluated in the market.

I always appreciate your help.

Best regards,

Woung-hee

Technical Manager (KICPA, USCPA)
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