Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition

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In October 2022, the IFRS Interpretations Committee (the Interpretations Committee) published an agenda decision, "Special Purpose Acquisition Companies (SPAC): Accounting for Warrants at Acquisition" (October 2022 Agenda Decision). In this agenda decision, the Interpretations Committee responded to a fact pattern where a SPAC raises cash in an initial public offering. Through a series of transactions, the SPAC becomes a wholly owned subsidiary of an entity that was privately held prior to the transaction. The acquisition of the SPAC allows the previously private entity to obtain the cash raised by the SPAC as well as its listing on a stock exchange. The SPAC does not meet the definition of a business in IFRS 3 *Business Combinations* and had no assets other than cash at the acquisition date. The acquisition of the SPAC is affected by the entity issuing new shares and warrants (replacement instruments) to replace the shares and warrants held by the original SPAC shareholders. The fair value of the replacement instruments exceeds the fair value of the SPAC's identifiable net assets.

Among the several issues about how to account for the transaction, the Interpretations Committee discussed which IFRS Accounting Standard applies to the instruments issued. The Interpretations Committee observed that:

- IFRS 2 *Share-based Payment* applies to the instruments issued to acquire the stock exchange listing because the stock listing is a "good or service" acquired in a share-based payment transaction.
- IAS 32 *Financial Instruments: Presentation* applies to the instruments issued to acquire the cash held by the SPAC because IAS 32 applies to the issuance of financial instruments with certain exceptions, including instances where IFRS 2 applies. IFRS 2 does not apply in this case because the accounting standard does not apply when equity instruments are issued to acquire financial assets (i.e., cash is not a "good or service").

See the agenda decision for the complete fact pattern and analysis.

The Group discussed this fact pattern at its May 2022 meeting. At that meeting, the Group also discussed the analysis of a fact pattern in which the SPAC acquisition is structured as a reverse acquisition, which was included in the Interpretations Committee's March 2022 Agenda Paper. However, the Interpretations Committee subsequently removed this analysis from its agenda decision as the submitter had not asked about the accounting for a reverse acquisition transaction in their original submission. Nonetheless, the analysis included in the agenda decision may indirectly affect how entities account for (or have previously accounted for) reverse acquisition transactions.

The Group first considered how the Interpretations Committee's October 2022 Agenda Decision interacts with the previous agenda decision "Accounting for reverse acquisitions that do not constitute a business" published in March 2013 (March 2013 Agenda Decision).

Background on the March 2013 Agenda Decision

With investors increasingly focusing on climate-related matters, entities should assess how climate change, including their commitments and actions to address climate change, may affect their financial statements and other reporting obligations. For example, entities may commit to net-zero

The March 2013 Agenda Decision analyzed a transaction in which the former shareholders of a non-listed operating entity become the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity. In this transaction, the listed non-operating entity acquires the entire share capital of the non-listed operating entity.

The March 2013 Agenda Decision set out that the legal acquirer would be identified as the acquiree for accounting purposes by applying the guidance in paragraphs B19-B27 of IFRS 3 on reverse acquisitions by analogy. This results in identifying the non-listed operating entity as the accounting acquirer, and it is deemed to have issued shares to obtain control of the listed non-operating entity. However, as the listed non-operating entity does not meet the definition of a business, IFRS 3 does not apply in accounting for the remainder of the transaction. Therefore, the Interpretations Committee noted that the transaction is a share-based payment transaction that should be accounted for in accordance with IFRS 2.

The Interpretations Committee observed that on the basis of the guidance in paragraph 13A of IFRS 2, any difference in the fair value of the shares deemed to have been issued by the accounting acquirer and the fair value of the accounting acquiree's identifiable net assets represents a service received by the accounting acquirer. The Interpretations Committee concluded that this difference is identified as a service of a stock exchange listing in exchange for the deemed shares and is recognized in profit or loss as it does not meet the recognition criteria in IAS 38 *Intangible Assets*.

Issue 1: Is the October 2022 Agenda Decision consistent with the March 2013 Agenda Decision?

Analysis

It may appear that the two agenda decisions are contradictory in that the October 2022 Agenda Decision states that two IFRS Accounting Standards apply to the instruments issued, whereas the March 2013 Agenda Decision concludes that only IFRS 2 applies. However, the precise wording and the differences between the fact patterns included in both agenda decisions should be considered.

The March 2013 Agenda Decision does not describe any of the assets or liabilities held by the listed non-operating entity, only that it was not a business as defined by IFRS 3 and was listed on a stock exchange. In addition, the March 2013 Agenda Decision notes that IFRS 2 applies only to any difference in the fair value of the deemed instruments and the acquired identifiable assets. It does not conclude that IFRS 2 applies to all the instruments deemed to have been issued by the non-listed operating entity. Finally, the March 2013 Agenda Decision does not consider how the shares issued to acquire any other identifiable assets or liabilities of the listed entity should be accounted for.

In contrast, the October 2022 Agenda Decision specifically indicates that the SPAC held cash and a stock exchange listing prior to being acquired. Therefore, it considered which IFRS Accounting Standards apply to acquire those two items.

Therefore, given the difference in the fact patterns considered in the two agenda decisions, the October 2022 Agenda Decision does not contradict the March 2013 Agenda Decision.

Group Discussion

Overall, the Group agreed that that the Interpretation Committee's October 2022 Agenda Decision does not contradict its March 2013 Agenda Decision for the reasons provided in the analysis. A couple of Group members thought the March 2013 Agenda Decision could be clarified to reflect that the transaction was in scope of IFRS 2 because the acquired listed non-operating entity is not a business, and the transaction did not include monetary items. One Group member thought it is unlikely that this type of transaction would not include any monetary assets or liabilities.

The Group then considered the potential effects of the October 2022 Agenda Decision on the following two reverse acquisition transactions.

Fact Pattern 2A

- A private operating company (Company A) is acquired through a share-for-share exchange by a small, listed company with no assets or liabilities (Company B).
- Company B becomes the legal parent of Company A, however, for accounting purposes, Company A is identified as the accounting acquirer. Therefore, this transaction is a reverse acquisition transaction.

Fact Pattern 2B

- Assume the fact pattern is identical to Fact Pattern 2A, except Company B holds $500,000 in cash, which it raised as a Capital Pool Company (CPC)®. The Toronto Stock Exchange website describes the CPC Program as "a unique Canadian invention that supports earlier stage private companies to complete a go public transaction." A qualifying transaction is "effectively a reverse takeover of a CPC by an operating business that will access the capital, shareholders, and expertise of the CPC to complete a listing" on a stock exchange. CPCs are subject to specific rules and regulations.

Issue 2: In both fact patterns, which IFRS Accounting Standards apply to the instruments deemed to have been issued by Company A?

Analysis

In Fact Pattern 2A, since Company B does not hold any assets or liabilities, the October 2022

Agenda Decision does not apply. Consistent with the March 2013 Agenda Decision, Company A should apply paragraph 13A of IFRS 2 to account for the instruments issued to acquire the stock exchange listing service.

In Fact Pattern 2B, since Company B holds both cash and a stock listing, the October 2022 Agenda Decision applies. Company A should apply IAS 32 to account for the instruments issued to acquire the cash and IFRS 2 to account for the instruments issued to acquire the stock exchange listing service.

The Group's Discussion

The Group agreed with the analysis. Some members noted that Fact Pattern 2A is not commonly observed in practice since generally there is some cash and liabilities and the listed company sometimes is in a net liability position. Two Group members thought the accounting conclusion in Fact Pattern 2B may not be how Canadian entities have historically accounted for these transactions. Therefore, entities will need to analyze past transactions and assess whether the application of the October 2022 Agenda Decision materially impacts their financial statements.

Issue 3: Implications of the October 2022 Agenda Decision on accounting practices

Analysis

In general, Canadian entities have applied IFRS 2 to account for the acquisition of a listed entity that does not meet the definition of a business, which is consistent with the March 2013 Agenda Decision. However, following the October 2022 Agenda Decision, entities may need to apply IAS 32 and IFRS 2 to two sub-sets of the shares deemed to have been issued by the accounting acquirer. This approach may have several financial reporting implications.

Classification of instruments issued

IAS 32 and IFRS 2 have different classification requirements for a financial instrument. For example, paragraph 16(b)(ii) of IAS 32 requires derivatives that meet the "fixed-for-fixed" criterion to be classified as equity. IFRS 2 has no such requirement. Therefore, two contractually identical instruments may be classified differently depending on whether they are within the scope of IAS 32 or IFRS 2.

Consequently, a misclassification between IAS 32 and IFRS 2 may result in significant differences in the subsequent measurement of a derivative liability. This is because the derivative liability that fails the "fixed-for-fixed" criterion is required to be remeasured at fair value through profit or loss under IAS 32 but would not be remeasured under IFRS 2. Therefore, if too few instruments are allocated to IAS 32 and their fair value changed significantly subsequent to the initial recognition, the measurement of these instrument may be materially misstated. Assessing materiality for this matter may be challenging for entities, especially those considering retrospective restatement.

Transaction Costs

Qualifying transaction costs associated with equity instruments issued in the scope of IAS 32 are accounted for as deductions from equity in accordance with paragraph 37 of IAS 32.

Transaction costs incurred relating to the issuance of instruments in the scope of IFRS 2 are recognized in profit or loss unless they meet the recognition criteria of another IFRS Accounting Standard. For example, transaction costs incurred in a share-based payment transaction to acquire an item of property, plant, or equipment are included in the cost of that item if they are eligible to be capitalized under IAS 16 *Property, Plant and Equipment*.

Retrospective Restatement

The October 2022 Agenda Decision is effective for financial statements with reporting periods ending on or after October 24, 2022, subject to entities having "sufficient time" to implement an agenda decision. Entities should refer to the IASB article, "Agenda decisions – time is of the essence" and the Due Process Handbook, Sections 8.2-8.7, for guidance on the timely implementation of agenda decisions.

If an entity thinks it needs to change its accounting policies to conform with the analysis in the October 2022 Agenda Decision, it would be required to do so on a retrospective basis per paragraphs 19-21 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Given the timing of the October 2022 Agenda Decision and the many reverse acquisition transactions in Canada that have occurred in the last 12-18 months, an entity that applies this agenda decision to a reverse acquisition transaction in the comparative period may have to do one or both of the following:

- restate comparative figures (e.g., presentation of transaction costs);
- reclassify financial instruments that continue to be recognized in 2022 and restate the accounting for any differences in the subsequent measurement requirements because of the reclassification.

The Group's Discussion

The Group agreed with the analysis and the potential accounting implications of applying the October 2022 Agenda Decision to both current and past transactions. One Group member commented that the retrospective restatement of these transactions may be immaterial to the extent that the instruments issued would be classified as equity in accordance with both IFRS 2 and IAS 32. Another Group member encouraged stakeholders to consider whether the October 2022 Agenda Decision may apply more broadly to other transactions, including asset acquisitions, when monetary items are acquired as part of the transaction.

Issue 4: Allocation between IAS 32 and IFRS 2 Analysis

Analysis

The October 2022 Agenda Decision sets out two approaches an entity may apply to determine what portion of the deemed instruments issued are in the scope of IAS 32 and IFRS 2. An entity could:

- allocate the shares and new warrants to the acquisition of cash and the stock exchange listing service on the basis of the relative fair value of the instruments issued (i.e., in the same proportion as the fair value of each type of instrument to the total fair value of all issued instruments.)
- use other allocation methods if they meet the requirements in paragraph 10-11 of IAS 8. However, an accounting policy that results in the entity allocating all the new warrants issued to the acquisition of the stock exchange listing service solely to avoid the new warrants being classified as financial liabilities applying IAS 32 would not meet these requirements.

The Group's Discussion

The Group agreed with the analysis.

The purpose of this discussion was to raise awareness of the interaction between the Interpretations Committee's October 2022 Agenda Decision and its March 2013 Agenda Decision, to illustrate the application of these agenda decisions to different fact patterns and to identify the implications of the October 2022 Agenda Decision on accounting practices. One group member commented that the classification and measurement differences between IFRS 2 and IAS 32 for the same financial instrument does does not generate comparable or meaningful information and questioned the usefulness of bifurcating instruments with the same terms into different standards with potentially different accounting classifications. The AcSB's interim Chair responded that while little can be done in the context of the recent Interpretations Committee's Agenda Decision, the AcSB may consider this in the context of its response to the IASB's forthcoming Financial Instruments with Characteristics of Equity project. No further action was recommended to the AcSB.