KPMG

SPAC interim accounting insights

November 2021

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In 2021, the number of Special Purpose Acquisition Companies (hereafter SPAC or SPACs) listed in Europe increased significantly. Whereas the SPAC has been a common way of listing in the United States for many years, in Western Europe only a limited number of SPACs have found their way to the capital market before 2021. Now, it seems that the trend on SPACs has reached Europe, though on the other hand we already notice that the hype is coming to an end.

For those SPACs listed in the first half of this year, 30 June 2021 was the first interim reporting date, which means an IAS 34-compliant report had to be published no later than 3 months after balance sheet date. Looking at companies listed in the Netherlands, France and Germany (on Euronext and Deutsche Börse, respectively), we have identified 11 SPACs publishing their interim financial statements.

It is typical to the nature and structure of a SPAC that the entity is an empty shell upon the IPO date and will remain empty until a merger or an acquisition has been effected – the so-called de-SPAC process. Upon the IPO, a SPAC issues various types of financial instruments in order to be prepared for future funding needs and pre-empt on the de-SPAC process. Although there can be differences among SPACs, on average we see that almost each SPAC issues the following instruments:

— Ordinary shares
— Listed warrants
— Founder shares
— Founder warrants

The names used for these instruments can differ per SPAC. Essentially, the distinction is that the first two instruments can be traded on the market and are held by 'ordinary' shareholders, while the latter two instruments are issued to the founders or sponsors of the SPAC and cannot be traded on a public market.

In this publication we have analysed the interim reports of 11 SPACs as of 30 June 2021 in regard to the accounting policies and disclosures around the aforementioned instruments.

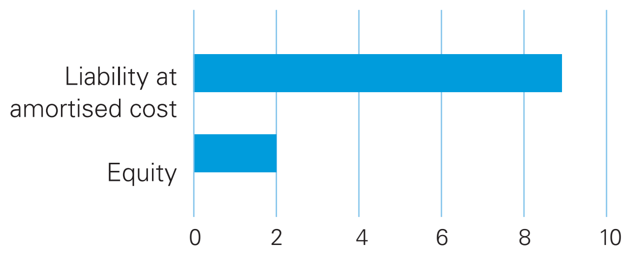
Ordinary shares

As part of the IPO, a SPAC issues listed shares to the ordinary shareholders. These ordinary shares are often priced at EUR 10 on the IPO date. The proceeds of issuing these instruments contribute to the cash balance which the sponsors will use to acquire an appropriate target. All interim reports disclose issuance proceeds being placed in an escrow account. The ordinary shareholders usually have the right to redeem their shares in return for cash if no target has been identified within 24 months following the listing date or if they vote against a business combination.

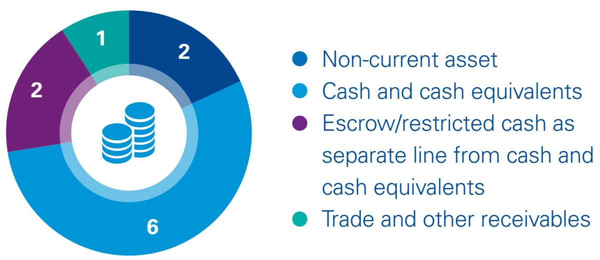
This redemption feature results in 9 out of the 11 companies presenting their ordinary shares as a financial liability at amortised cost. This classification fits with the IFRS requirement that issued instruments resulting in a future cash outflow, which cannot be avoided by the issuer, do not qualify as equity instruments. Only 2 SPACs conclude that the ordinary shares with redemption features qualify as equity.

All SPACs report that the cash from issuance of ordinary shares is held in an escrow account, and redemption features of the shares seem to apply commonly at all SPACs. This raises the question why 2 SPACs deem the cash outflow to be avoidable and hence do not classify the instrument as a financial liability.

Classification of ordinary shares



Presentation cash proceeds



We note that the balance sheet presentation of the cash proceeds of share issuance also differs across the SPACs. Slightly more than 50% of the entities present the proceeds as part of the cash and cash equivalents. However, 2 companies report the proceeds as non-current asset, another 2 report it as an escrow line item clearly separated from cash and cash equivalents, while one entity concludes that the escrow balance falls under trade and other receivables. The different ways of presentation in the face of balance sheet has its implications on how entities present their liquidity position and cash flow statement.

Listed warrants

With regard to the listed warrants, we see a great consistency in accounting treatment applied. Except for one entity, all SPACs have classified these instruments as a derivative financial liability with an accounting policy to recognize the instruments at fair value, with fair value changes presented in the statement of profit and loss. Valuation methods are described and fair value information is provided in general.

Founder shares

Looking at the founder shares there appears to be more diversity in the accounting policies applied.

Classification founder shares

- Share-based payment (in-scope of IFRS 2)
- Equity instrument (in scope of financial instruments standard)
- Equity instrument, but still assessing and potentially in scope of IFRS 2

We noted 7 SPACs consider founder shares to be an equity instrument in scope of the Financial Instruments standards, while 4 SPACs mention the founder shares fall in scope of IFRS 2 Share-based Payments. It is remarkable though that 2 SPACs seem not to have formally concluded on the classification of these instruments. Although presented as equity instruments in the interim financial statements, the 2 SPACs disclose in the notes that they are still assessing whether the instruments fall in scope of IFRS 2 and that their final position will be based on market developments and views of the standard setter. We find such disclosure to be very unusual, highlighting that the accounting policy is subject to change.

As can be noted from the accounting guidance published on this topic, the key assessment to be made by management in classification of founder shares is whether issuance of these shares can be deemed a true shareholder transaction.

Alternatively, founder shares could be deemed a share-based payment in scope of IFRS 2, issued in exchange for services provided by the sponsors, namely running the SPAC, searching and executing of a business combination. In that case, IFRS 2 would require similar accounting treatment as if the sponsors were paid for their services in cash. We acknowledge that this assessment can be judgemental and that an entity should consider all facts and circumstances. However, we note in the disclosures of the SPACs that each structure seems more or less the same in a sense that founders acquire their founder shares at a nominal value and can exchange them for an ordinary share 1-on-1 upon successful execution of the business combination. We also see that, in a number of the SPACs, there seems to be a (significant) value gap between the nominal value of a founder share and the EUR 10 of an ordinary share. In our view, such a value gap is, at least, an indication that the instrument could fall in scope of IFRS 2. Still, it's interesting to observe such a considerable diversity in practice and, especially, the cases where ongoing status of the accounting assessments is disclosed in relation to these instruments.

We will explain the implications of the two accounting methods:

— accounting for founder shares as equity instrument results in recognition of the cash proceeds received and a corresponding credit in equity upon issuing the instrument. In general, no accounting implications are expected until the realisation of the business combination.

— if the founder shares fall in scope of IFRS 2, the SPAC should then follow the accounting guidance on share-based payments. This would trigger many new accounting questions, such as (i) what is the grant date, or (ii) does it include a service (vesting) or any other conditions.

Assuming to be in scope of IFRS 2, the instrument will be classified as equity-settled and, hence, still be recognised in equity. However, contrary to the treatment of a shareholder transaction, it will eventually impact the statement of profit and loss. Under IFRS 2 a fair value needs to be determined at grant date, which may differ from the nominal value. This grant date fair value should be recognised in the profit and loss as an expense compensating for the services provided. The recognition in the profit and loss may be at once, if there are no further vesting conditions (there is no remaining service required by the holder), or over time when the instruments vest over the duration of the service. One could argue that the IFRS 2 treatment also provides useful information to users on the financial statements. Although the technical mechanism of the founder shares and its conversion right is clearly explained, the value locked in by the founders through these instruments would be more clearly visible if presented as an expense to the organization.

As of 30 June 2021, 4 SPACs have accounted for founder shares in scope of IFRS 2, while 2 SPACs are still considering to do so. However, only 1 out of the 4 SPACs acknowledges that the recognition criteria are met and has already recognised a charge in the profit and loss account. This triggers the question about how SPACs' management has analysed and interpreted IFRS 2, resulting in the recognition of income or expense in the current period, or lack thereof.

Founder warrants

In accounting for the founder warrants there also seems to be diversity in practice. 7 SPACs have classified these instruments as a derivative financial liability with accounting at fair value, with fair value changes presented in profit and loss. However likewise, as noted under the founder shares, management of 2 SPACs disclosed that they are still assessing whether the instruments fall in scope of IFRS 2. Another 2 SPACs have already classified these instruments as share-based payments, while 1 SPAC has classified it as an equity instrument.

Founder warrants

- Derivative financial liability
- Derivative financial liability but still assessing and potentially in scope of IFRS 2
- Share-based payment (in scope of IFRS 2)
- Equity instrument (in scope of financial instruments standard)
- Not applicable

Likewise, as noted above under the founder shares, the accounting policy applied for initial recognition can lead to a difference in the subsequent accounting. If the warrants are in scope of IFRS 2, and assuming an equity-settled instrument, no remeasurement in subsequent periods is needed. However, if not initially issued at fair value, these instruments can still lead to recognition in the profit and loss account as share-based payment expenses. On the other hand, accounting for warrants as a derivative financial liability does result in debt being presented on the balance, and would require fair value movements to be recognized through profit and loss each period.

In our view, another key assessment to be made is whether the founder warrants should be treated as a single contract jointly with the founder shares, or can the instruments be accounted on a stand-alone basis.

Disclosures

We have noted there is a level of diversity in the extent of disclosures provided. Some entities describe their accounting policies in more detail, or explain assessments performed and key assumptions made in more detail than others. Looking again at the common instruments issued by the SPAC, and the requirements in IAS 34, one could argue that IAS 34 does not explicitly prescribe disclosures around financial instruments or share-based payments in interim reports. However, one could also argue that under IAS 34.15C more disclosures could be reported. IAS 34.15C requires that, when an event or transaction is significant to an understanding of the changes in an entity's financial position or performance since the last annual reporting period, its interim financial report should provide an explanation of, or and an update to, the relevant information included in the financial statements of the last annual reporting period. On top of this, more extensive disclosures could be expected given that, following initial set up in the first half of this year, 30 June 2021 was the first set of financial reports published by these SPACs.

Closing

Overall, it can be noted that there are quite a few differences in the accounting policies applied among the SPACs in their interim reports. This may be caused by differences in terms and conditions of the respective instruments, which would substantiate a certain accounting treatment. Until 2020, the number of SPACs in the countries under review was limited, making for fewer observable market practices. Although SPACs are more common in the United States, there are some differences in the relevant accounting standards under IFRS and US GAAP, making a direct comparison more challenging. In addition, relevant market practice in the United States have also moved over time. Some practical guidance on accounting for SPACs under IFRS came out in 2021, providing helpful considerations but not definitive conclusions.

We expect, in any case, that in the annual reports as of 31 December 2021, more detailed disclosures will be reported by the SPACs in respect of their accounting policies and management assessments.

Since July, several new SPACs were listed. As a result, the number of SPACs that will report publicly available financial information will increase for the upcoming year-end. We will see to what extent accounting diversity will remain or whether convergence will occur among the SPACs!

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