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SEC Staff Issues Additional Guidance for SPACs

On March 31, 2021, the Staff of the SEC's Division of Corporation Finance issued a Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies (available here) and the Acting Chief Accountant issued a public statement on Financial Reporting and Auditing Considerations of Companies Merging with SPACs (available here). Together, these statements serve as a reminder of certain key issues that SPACs and potential SPAC acquisition targets should take into account.

Issues Identified by Corporation Finance Staff

Shell Company Restrictions. Because a SPAC is a shell company, any post-initial business combination entity will be subject to certain limitations as compared to a company that goes public through a traditional IPO, including with respect to:

- **Business combination Form 8-K**: financial statements for the acquired business (*i.e.*, the target of the SPAC's initial business combination) required by Item 9.01(c) must be filed within four business days (the registrant will not be entitled to the 71-day extension).
- **Incorporation by reference**: the registrant will not be eligible to incorporate its Exchange Act filings by reference in a Form S-1 registration statement until three years after the completion of the initial business combination.
- **Form S-8**: the registrant will not be eligible to use a Form S-8 registration statement to register compensatory equity offerings until 60 calendar days after it has filed its current Form 10 information (which is due on Form 8-K within four business days of the completion of the business combination, as discussed in the first bullet above).
- **"Ineligible issuer status"**: pursuant to Securities Act Rule 405, the registrant will be an "ineligible issuer" for three years following the business combination, and as a consequence, during that time:
  - cannot qualify as a well-known seasoned issuer;
  - may not use a free writing prospectus (including using a term sheet free writing prospectus available to other ineligible issuers, or conducting a roadshow that constitutes a free writing prospectus); and
  - may not rely on the Rule 163A safe harbor for pre-filing communications.

Books and Records. Registrants are subject to the SEC's books and records and internal control requirements as well as requirements related to internal controls over financial reporting ("ICFR") and disclosure controls and procedures ("DCP"), and these apply equally to SPACs. Some requirements apply immediately upon an IPO, while others have grace periods. Any such grace periods are tied to the date of the IPO, not to the date of the business combination. SPACs should be mindful of these requirements beginning with their IPOs, and SPACs and their targets should be equally mindful of these requirements post-initial business combination. The parties may need to develop new processes and controls on an accelerated timeline following the initial business combination as compared to a traditional IPO.

The Staff notes that management of a SPAC may be unable to assess the SPAC's internal control over financial reporting in the fiscal year in which the initial business combination is consummated, in which case the Staff would not object if the combined company were to exclude management's assessment of internal control over financial reporting in the Form 10-K covering the fiscal year in which the transaction was consummated (see Compliance and Disclosure Interpretation for Regulation S-K, Question 215.02).

Initial Listing Standards. SPACs and their targets should consider and ensure that post-business combination they will be able to meet both qualitative listing standards (corporate governance, especially due to the abbreviated timeline many SPAC targets face to become public company-ready) and quantitative listing standards (share price, market value, number of public holders and round lot holders, especially after a redemption). The Staff notes that, in the event of a failure to meet these requirements, SPACs should ensure they are meeting applicable disclosure requirements (for example, filing a Form 8-K to report any notice of non-compliance from its exchange and company response under Item 3.01).

Financial Reporting and Auditing Considerations

Market and Timing Considerations. SPACs and target companies should ensure that the target companies have an experienced management team and comprehensive plan in place to meet the demands of becoming a public company on an accelerated timeline, and sufficient resources (knowledgeable personnel, processes and technology) to meet SEC filing, audit, tax, governance and investor relations needs.

Financial Reporting Considerations. In addition to reiterating the need for target companies to put in place a finance and accounting team that will enable them to meet SEC filing requirements, the acting Chief Accountant noted a few specific areas where targets encounter complex accounting and reporting issues:

- **Accounting standard determination**: whether financial statements should be prepared in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") or alternatively may be prepared in accordance with International Financial Reporting Standards (*e.g.*, if the combined public company will be eligible to report on forms applicable to foreign private issuers);

- **Public company disclosure requirements**: including issues related to the identification of the predecessor entity, the form and content of financial statements and the preparation of pro forma financial information;

- **Identification of the acquirer for accounting purposes**: including variable interest entity considerations, and whether the transaction is a business combination or reverse recapitalization;

- **Other accounting matters**:

  - Accounting for earn-out or compensation arrangements and complex financial instruments;

  - Application of GAAP for public business entities (*e.g.*, earnings per share, segment disclosures and expanded disclosure requirements for certain topics such as fair value measurements and post-retirement benefit arrangements) and the related reversal of any previously-elected Private Company Council accounting alternatives available to private companies; and

  - Determination of the effective dates of recent accounting standards (*e.g.*, leases and current expected credit losses), with certain public companies eligible to adopt those standards on a timeline that is generally more aligned with the effective dates applicable to private companies; the evaluation of, and preparation for, any potential acceleration of adoption of those standards if the company's status changes; and the required disclosure of the impact those standards will have when adopted.

Internal Control Considerations. Target companies must, on a timeframe more accelerated than a typical IPO, develop ICFR and DCP. In particular, the Acting Chief Accountant noted that companies need to understand the applicability and timing of various requirements (*i.e.*, annual ICFR assessments, auditor reports on ICFR, quarterly evaluations of disclosure controls and procedures).

Corporate Governance and Audit Committee Considerations. SPACs and target companies should set to work early to identify appropriate board candidates to ensure that the post-initial business combination public entity will have a sufficiently independent board whose members have the necessary skill and preparation for committee assignments and general corporate oversight. A key focus should be ensuring that the audit committee will be strong, effective, knowledgeable and independent, to ensure that the audit committee is able to clearly and effectively communicate with management and the auditors.

Auditor Considerations. The process of moving from a private company to a public company raises a number of auditor-related issues that SPACs and target companies need to assess early in the process because of the significant time it may take to resolve them (particularly if the target company needs to retain a new auditor or have additional audit procedures performed in respect of its historical financial statements):

- **Standards** – public company financial statements must be audited in accordance with the Public Company Accounting Oversight Board ("PCAOB") standards by a firm registered with the PCAOB. If the target company's audits have historically been performed under American Institute of Certified Public Accountants ("AICPA") audit and independence standards as opposed to PCAOB standards, the auditors will need to consider changing or augmenting the audit engagement team to make certain that the audit engagement team has the appropriate experience in auditing SEC registrants under PCAOB standards.

- **Acceptance and Continuance Procedures/Independence** – auditors will need to consider whether the appropriate acceptance and continuance procedures have taken place as their private audit client transitions to a public company, and must carefully consider their independence under SEC rules. The acting Chief Accountant noted the general principle: "an auditor is not independent if, among other things, he or she would be in a position of auditing his or her own work or if he or she acts as management" and encouraged SPACs, targets and auditors with questions to reach out to the Office of the Chief Accountant.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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