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The Impact of the Recent SEC Staff Statement on Accounting and Reporting Considerations for Warrants Issued by SPACs

Since John Coates, Acting Director of the SEC Division of Corporation Finance, and Paul Munter, Acting SEC Chief Accountant, published their Staff Statement on Accounting and Reporting Considerations for Warrants Issued by SPACs on April 12, 2021 (available here), SPAC issuers and their advisers have been evaluating how best to address the issues raised. The Staff is of the view that certain common SPAC warrant terms could cause SPAC warrants to be classified as a liability rather than equity under U.S. GAAP, in which case previously filed financial statements may need to be revised or restated. The impact of the Staff Statement on any particular SPAC will depend upon the terms of each SPAC's warrants and such SPAC's specific circumstances. In this client alert, we summarize the considerations raised by the Staff Statement for SPACs at various stages in their lifecycles.

What warrant terms could cause the warrants to be treated as a liability instead of equity?

Indexation: The Staff Statement states that if the warrants provide for potential changes to the settlement amounts depending upon the characteristics of the holder of the warrant (e.g., private warrants vs. public warrants), such provisions would preclude the warrants from being considered indexed to the entity's stock, and the warrants should be classified as a liability measured at fair value, with changes in fair value reported each period in earnings.[1]

Virtually all existing SPACs with a warrant structure provide that upon a transfer the private warrants lose certain special features (e.g. the non-redeemable feature) and become fungible with the public warrants. Based on discussions with certain of the SPAC accounting firms, it appears that the combination of the special features of the private warrants and their fungibility with the public warrants results in an indexation issue that will cause virtually all private warrants in existing SPAC structures to be reclassified as liabilities for accounting purposes. This has already resulted in numerous SPACs restating their financial statements in their annual reports (and any quarterly reports filed since their last annual report).

Tender/exchange offer provisions: The Staff Statement also states that if the warrants provide for net cash settlement upon the occurrence of an event outside of the entity's control, and in such circumstance not all

[1] This treatment results because the variable (the holders' characteristics) are not inputs to the fair value of a fixed-for-fixed forward or option on equity shares under U.S. GAAP. If the warrant terms provide for changes based on other variables that are also not inputs to the fair value of a fixed-for-fixed forward or option on equity shares, such provisions would also preclude the warrants from being considered indexed to the underlying stock, and result in the classification of the warrants as a liability.

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holders of the underlying equity securities would receive cash (for example, if the warrants provide that upon the acceptance of a tender or exchange offer by more than 50% of the holders of the outstanding common stock, the holders of the warrants would be entitled to receive cash for all their warrants whereas holders of common stock may receive a mix of consideration or may not have all their shares of common stock accepted if the offer is for less than all of the outstanding shares of common stock), then the warrants should be classified as a liability measured at fair value, with changes in fair value reported each period in earnings.

What are the next steps?

Registrants should consult with their auditors and legal advisors to evaluate the terms of their warrants and determine whether the warrants need to be re-classified as a liability. If so, the next steps may vary depending on where the SPAC is in its lifecycle and the materiality of the accounting error. In all cases, registrants should take care not to selectively disclose material non-public information.

Pre-SPAC IPO

Pre-IPO SPACs will have the option of revising the terms of their warrants to ensure that they may be classified as equity or revising their registration statement disclosures to reflect the classification of the warrants as a liability. SPACs should anticipate that the process of confirming with the Staff the accounting treatment for alternative warrant structures to avoid classification of warrants as a liability may take some time, at least for the early movers. SPACs should also review their risk factor disclosures and, if not already included, consider adding a risk factor that similar reclassifications, based upon updated or revised accounting guidance or interpretations, could occur in the future.

All Stages Post-SPAC IPO

Registrants will need to evaluate whether their warrants include the provisions highlighted in the Staff Statement and, if applicable, consider whether a reclassification of the warrants as a liability is appropriate. Following a decision to reclassify the warrants, the registrant will need to evaluate the materiality of the accounting error in accordance with Staff Accounting Bulletin ("SAB") No. 99 – Materiality (codified in SAB Topic 1, Section M – *Materiality*, available here). A conclusion that the error is material within the meaning of SAB No. 99 will necessitate the restatement of previously-issued financial statements. However, each SPAC will need to conduct its own analysis and certain SPACs (for example, those with lower warrant coverage) may be able to determine that the reclassification is not material.

SPACs should also review their risk factor disclosures and, if not already included, consider adding a risk factor that similar reclassifications based upon updated or revised accounting guidance or interpretations could occur in the future.

Post-SPAC IPO/Pre de-SPAC Agreement

Not material: if the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K.

Material: if the registrant determines that the error is material, it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements, including filing amended Form 10-Ks and Form 10-Qs, as applicable.

Post de-SPAC Agreement Signing/Pre-Effectiveness of Business Combination Registration Statement/ Definitive Merger Proxy

We understand that the SEC will not declare registration statements effective or clear merger proxy statements until the registrant has made a determination regarding materiality and restatement, and appropriate filings have been made. This will add a delay to the filing and review of registration and proxy statements (and amendments thereto).

Not material: we expect that the registrant would need to restate the most recent historical period information included in the de-SPAC registration or merger proxy statement on amended Forms 10-K and 10-Q prior to its next registration or merger proxy statement filing. In order to facilitate the processing of pending submissions, the Staff has encouraged registrants to provide, via EDGAR, a written representation that such accounting error(s) are not material to the required financial statements and disclosures included in pending submissions and filings.

Material: the registrant will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements before proceeding with any further registration or proxy statement filings (which too would require amendment to reflect the restatement).

Post-Effectiveness/Pre-Shareholder Meeting

In addition to analyzing the materiality of the accounting error for the purposes of determining whether to restate previously-issued financials, the registrant will need to evaluate the materiality of the financial statement changes to the investment decision to vote with respect to the transaction. Depending on the outcome of its materiality analysis, the registrant may need to file a Form 8-K to explain the change, or revise, reprint and re-mail the documents to shareholders.

Not material: if the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K. SPACs which have not yet held their

meeting should consider providing shareholders with disclosure around the potential impact of the revisions on a Form 8-K prior to the shareholders meeting.

Material: if the registrant determines that the error is material, it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements. Each SPAC will need to evaluate the effect of this on its meeting materials to consider whether qualitative disclosure about the potential impact on the financial statements can be provided on a Form 8-K or the changes would require more significant amendments to the effective registration statement or definitive proxy statement. There are potential scenarios where additional disclosure would require a re-mailing of the materials.

Post-Shareholder Meeting

Within four (4) business days of closing a de-SPAC transaction, the combined company is required to file a "Super Form 8-K" which includes current financial statements. Parties should consider whether to delay the closing of the transaction to ensure that there is sufficient time to assess the materiality of the accounting error and prepare revised or restated financial statements, as necessary, so that accurate financial statements are filed with the Form 8-K.

Not material: if the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K, which would then be included in the post-closing Form 8-K.

Material: if the registrant determines that the error is material, it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements prior to including them in the post-closing Form 8-K.

Post de-SPAC Transaction Closing

Following a de-SPAC transaction, the resulting public company inherits the SPAC warrants and may also be affected by this issue.

Not material: if the registrant determines that the error is not material, then it would revise its financial statements in its next periodic report on Form 10-Q or Form 10-K.

Material: if the registrant determines that the error is material, then it will need to file an Item 4.02 Form 8-K (Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review) and restate the previously-issued financial statements. Registrants will need to consider

how this determination will affect any near-term plans to raise capital in the public markets and any existing "shelf" registration statements.

Internal control over financial reporting and disclosure controls and procedures

Regardless of SPAC lifecycle stage or materiality, the registrant should consider evaluating its internal control over financial reporting and disclosure controls and procedures to determine whether the controls are adequate in light of the error. The registrant should consider whether its prior evaluations should be revised in any amended filings that will need to be made, and should analyze whether there is a control deficiency and the severity of any control deficiency identified. The Staff Statement notes that the evaluation of the severity of a control deficiency should consider the potential misstatement arising from the deficiencies, not just the actual misstatement that occurred or whether it was material. Where applicable, the registrant's auditor will also need to evaluate management's assessment.

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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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