No. 2019-03
Updated 21 March 2024

Technical Line

Navigating the requirements for merging with a special purpose acquisition company

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What you need to know

- Merging with a SPAC offers an alternative to an IPO for private companies that want to enter the public markets.
- All companies that are considering merging with a SPAC should be aware of the special accounting and financial reporting requirements, which generally align with those of traditional IPOs.
- All companies that merge with SPACs must provide financial statements that comply with Regulation S-X for the joint registration statement and proxy statement filed for the de-SPAC transaction. The financial statements of companies reporting under US GAAP must also meet the requirements for public business entities.
- De-SPAC transactions require significant coordination between buyers, sellers and management of the target company.
- This publication has been updated to incorporate the SEC's recently adopted rules for SPACs, most of which are effective 1 July 2024.

Overview

Merging with a special purpose acquisition company (SPAC) offers private operating companies a way to go public without conducting an initial public offering (IPO). A SPAC is a blank-check company that raises capital from investors in an IPO to use in the future to acquire a private operating company (also referred to as the target company) that has not been identified at the time of the IPO.

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SPAC activity surged in 2020 through 2022, when more than half of the IPOs in the US were conducted by SPACs. The increase in SPAC transactions attracted scrutiny from the Securities and Exchange Commission (SEC or Commission) with the staffs of the **Division of Corporation Finance** and the **Office of the Chief Accountant** issuing separate statements on the risks related to SPAC transactions. The SEC staff emphasized the need for management of newly merged public companies to understand and comply with both the general requirements in the Exchange Act to maintain adequate books and records and the Sarbanes-Oxley Act to maintain effective internal controls over financial reporting and disclosure controls and procedures over all disclosures in their SEC filings.

Despite more recent declines in the IPO market, the SEC **adopted** new and amended rules in January 2024. The SEC said the rules are intended to address concerns about investor protection by more closely aligning the requirements and legal obligations related to de-SPAC transactions (i.e., when a SPAC combines with a private operating company) with those related to traditional IPOs. The new rules also codify existing staff guidance for transactions involving shell companies, including SPACs, and require new disclosures for both SPAC IPOs and de-SPAC transactions, among other related changes.

The new rules are effective 1 July 2024, except for the structured data requirements (i.e., tagging the information disclosed as required under new Subpart 1600 of Regulation S-K in Inline XBRL), which are effective 30 June 2025.

Key considerations

Understanding the SPAC structure and life cycle

Upon formation, a SPAC is initially capitalized by sponsors, who contribute nominal capital or fund formation and offering costs in exchange for founder shares that typically make up 20% of the shares of the company after the IPO, assuming the underwriters don't exercise an overallotment option. The SPAC then files an initial registration statement on Form S-1 with the SEC to conduct its IPO.

A SPAC's pre-IPO balance sheet usually presents only deferred offering costs, the statement of operations presents nominal operating expenses consisting of organizational and startup expenses, and the statements of shareholders' equity and cash flows reflect the issuance of founder shares to the sponsors. Because a SPAC typically qualifies as an emerging growth company (EGC), it may elect to provide reduced disclosures. A SPAC's IPO registration statement also doesn't have to include any financial statements of businesses to be acquired under Rule 3-05 of Regulation S-X if, as is usually the case, it hasn't yet identified a potential target at the time of its IPO registration statement.

After the IPO, a SPAC must promptly file an audited balance sheet under Item 8.01 of Form 8-K showing at least $5 million in net tangible assets (i.e., total assets less intangible assets and liabilities) to avoid classification as a blank-check company subject to the requirements of Rule 419 of Regulation C, which, among other things, restricts trading of a blank-check company's securities. A SPAC must also comply with normal public company periodic Exchange Act reporting obligations.

The units sold in a SPAC IPO typically comprise one share of common stock and a warrant to purchase one-half of one share of common stock in the future. The warrants, which become exercisable shortly after the SPAC acquires a target company, are issued with a strike price that is out of the money (usually 115% of the price per unit in the IPO). They are intended to compensate holders for investing their capital in the SPAC before it acquires a target company. Refer to the *Pro forma financial information and transaction accounting* section below for a discussion of the accounting for warrants. The sponsors may either retain the management of the target company to manage the combined entity or actively participate in managing the combined entity.

Status of SPACs under the Investment Company Act of 1940

Depending on the facts and circumstances, a SPAC may meet the definition of an investment company under Section 3(a)(1) of the Investment Company Act; therefore, a SPAC must assess its status as an investment company based on its activities both at inception and throughout its existence. The SEC provided illustrative guidance in the adopting release for the new SPAC rules to address factors that may raise concern about a SPAC's status as an investment company. Considerations include the nature of the SPAC assets and income, the activities of management, the duration of the SPAC, how a SPAC markets itself as an investment opportunity and whether the SPAC engages or proposes to engage in a de-SPAC transaction with an investment company.

While the duration of a SPAC is not the sole determinant of its status, the guidance indicates that a SPAC's activities may become more difficult to distinguish from those of an investment company the longer the SPAC takes to achieve its stated business purpose.

De-SPAC transaction requirements

Once a SPAC identifies a target company, the SPAC prepares a proxy statement to solicit shareholder approval for various aspects of the de-SPAC transaction, including:

- The proposed transaction
- The issuance of securities
- The election of the board of directors of the combined company
- The establishment of incentive compensation plans of the combined company
- Other organizational and governance-related matters

A SPAC files a proxy statement on Schedule 14A or, if it intends to register new securities as part of the transaction, a joint registration and proxy statement (joint statement) on Form S-4. The new rules require that these disclosure documents generally be disseminated to investors at least 20 calendar days before shareholders vote to approve the transaction.

In addition to the proposals for shareholder approval listed above, the proxy statement or joint statement contains the following items (each of which is discussed further in the sections below):

- Various nonfinancial statement disclosures, including those related to the target(s)
- Financial statements of the SPAC, target(s) and other entities, such as businesses acquired by the target or equity method investees of the target, to comply with Regulation S-X Rules 3-05 and 3-09
- Unaudited pro forma financial information reflecting the proposed acquisition and any other material transactions
- Management's discussion and analysis (MD&A) of the SPAC and target(s)

When a registration statement (e.g., Form S-4) is filed for a de-SPAC transaction, the new rules require the target company to be a co-registrant along with the SPAC entity. As signatories to the registration statement, the target company and its signing persons (e.g., principal executive, financial and accounting officers, board of directors) are subject to liability for untrue material statements and material omissions under Section 11 of the Securities Act of 1933 (Securities Act), in addition to the SPAC and its officers and directors.

In addition, the new rules include general guidance addressing statutory underwriter status in the de-SPAC transaction. The SEC indicated that the transaction's facts and circumstances would need to be evaluated, and if a distribution and an underwriter are present, the party acting as underwriter will need to perform the necessary due diligence to benefit from the due diligence defense under the Securities Act.

How we see it

The SEC's guidance on the role of an underwriter in a de-SPAC transaction continues to underscore the SEC's view of the critical role of underwriters in the securities offering process. While the SEC did not deem the underwriter in a SPAC IPO to be an underwriter in a de-SPAC transaction under the new rules, we have observed an increase in the level of due diligence conducted by those involved in de-SPAC transactions since the SEC issued its proposal.

Nonfinancial statement disclosure requirements

In addition to the various existing nonfinancial statement disclosure requirements for a proxy statement or Form S-4, the new Subpart 1600 in Regulation S-K requires specialized disclosures for de-SPAC transactions and the initial SPAC IPO (as discussed above), including:

- Disclosures about the SPAC sponsor (e.g., its experience, responsibilities, interests, compensation), the target company, and potential or actual material conflicts of interest
- Detailed disclosures of the potential impact of dilutive events that may occur over the SPAC's lifespan (e.g., shareholder redemptions, sponsor compensation, warrants, financings)
- A determination by the board of directors (or similar governing body) on whether the de-SPAC transaction is advisable and in the best interests of the SPAC and its shareholders (when required by the law of the jurisdiction in which the SPAC is organized) and disclosure of that determination, along with a discussion of the factors considered, including whether the SPAC or SPAC sponsor has received an outside report, opinion or appraisal materially relating to the approval or fairness of the transaction (if so, it is included or filed as an exhibit)
- Certain disclosures, including features related to the SPAC offering or de-SPAC transaction and the potential associated risks, on the prospectus cover page and in the prospectus summary

In addition, the new rules require nonfinancial statement disclosures related to the target company that are more closely aligned with the required disclosures for a traditional IPO. For example, disclosures such as the description of the business (Item 101), legal proceedings (Item 103) and recent sales of unregistered securities (Item 701) will now be required in the proxy statement or Form S-4, which will provide shareholders with this information before they make voting, investment or redemption decisions. Previously, such disclosures were generally not made until the filing of the Form 8-K after the close of the de-SPAC transaction.

Projections

SPACs often include projections for the target company in these filings to facilitate shareholder review and approval of the transaction. Projections, if included, should be based on reasonable assumptions and should represent a balanced view. They should also be identified as forward-looking statements and accompanied by meaningful cautionary statements describing factors that could cause actual results to differ materially from the projection.

Under the new rules, the safe harbor from liability for forward-looking statements, including projections, under the Private Securities Litigation Reform Act, is unavailable to blank-check companies, including SPACs. The definition of a blank-check company was amended to include SPACs and certain other companies, resulting in treatment similar to that of a traditional IPO.

Further, amended Item 10(b) of Regulation S-K requires projected measures that are not based on historical financial results to be "clearly distinguished" from those that are and for corresponding historical results to be presented with equal or greater prominence. When projections include a non-GAAP financial measure, disclosures must also include a clear definition or explanation of those financial measures, a description of the GAAP financial measure to which the non-GAAP financial measure is most directly comparable, and an explanation why the non-GAAP measure was selected instead of a GAAP measure.

New Item 1609 of Regulation S-K, which applies only to de-SPAC transactions, requires disclosure of the purpose for which projections of both the SPAC and target company were prepared, the party that prepared the projections, and material bases and assumptions underlying the projections (including any material factors affecting such assumptions). The disclosures also must indicate whether the projections reflect the views of the SPAC or the target company's management or board of directors as of the most recent practicable date before the dissemination of the disclosure document to security holders. Item 1609 also applies to any Form 8-K report or exhibit related to a de-SPAC transaction.

Determining the predecessor and the accounting acquirer requires separate analyses, and they can be different entities.

Financial statements

Determining the predecessor

Entities involved in de-SPAC transactions have to determine which entity is the predecessor whose financial statements will become the historical financial statements of the combined company. This determination is separate from the determination of which entity is the accounting acquirer, which is discussed below.

Because SPACs generally have nominal operations and will acquire one or more businesses in a de-SPAC transaction, at least one of a SPAC's targets must be designated as the predecessor of the combined entity. Most SPAC transactions involve only one target company, which makes determining the predecessor straightforward.

In transactions involving more than one target company, judgment is required to determine which entity is the predecessor. The predecessor is the acquired business that will constitute the major portion of the business or operations of the combined entity. Factors to consider include the relative size and fair value of the entities and the ongoing management structure and operations of the combined entity. None of these factors is determinative, and all facts and circumstances need to be evaluated. In rare situations where there is no clear predecessor, multiple target companies may be determined to be predecessors.

Age and content of financial statements

The proxy statement or joint statement provides the financial statements for both the SPAC and the target(s). Additional financial statements of businesses acquired by the target(s) and equity method investees of the target(s) may also be required under Rules 3-05 or 3-09 of Regulation S-X, respectively.

Specifically, new Rule 15-01(d) requires the application of Rule 3-05 (Rule 8-04 if the predecessor qualifies as a smaller reporting company (SRC)) or Rule 3-14 (Rule 8-06 if the predecessor qualifies as an SRC) to acquisitions of a business or real estate operation, respectively, by a predecessor, consistent with a traditional IPO. The significance of an acquired business that is not the predecessor is calculated using the predecessor's financial information as the denominator instead of that of the SPAC.

For both the SPAC and the target company, audited financial statements should be provided for the three most recently completed fiscal years (or since inception), and unaudited financial statements should be provided for any interim periods that are required to meet the age requirements discussed below. However, if both the SPAC and the target company (if it were conducting its own IPO) would qualify as EGCs, the new rules permit the target company to report two years of financial statements.

If the target company qualified as an EGC at the time of the initial filing of the proxy statement or joint statement but subsequently fails to qualify as an EGC as of the effective date of the proxy statement or joint statement, the SEC staff has indicated that it would not object to the registrant applying EGC accommodations to the target company (including those related to financial statement periods, accounting standards adoption dates and disclosure of critical audit matters (CAMs)) in the proxy statement or joint statement (including amendments through the effective date of the Form S-4 or mailing date of the proxy).

However, a registrant that loses its EGC status cannot apply the EGC accommodations in any filings made after the effective date of the proxy statement or joint statement for the de-SPAC transaction (see *Post-transaction Exchange Act reports* section below).

The SPAC may also present two years of financial statements for the target company if the target company would meet the definition of an SRC. To qualify as an SRC, the non-reporting target company must apply US GAAP and have annual revenue of less than $100 million in its most recent fiscal year for which financial statements are included in the proxy or Form S-4 registration statement. See *SRC status subsequent to the de-SPAC transaction* below for additional discussion on the redetermination of SRC status following a de-SPAC transaction.

Under the new rules, a registrant can exclude the SPAC's financial statements for periods before the acquisition of the target company from filings made after the de-SPAC transaction once the predecessor target company's financial statements have been filed for all required periods through the acquisition date and the registrant's financial statements include the period in which the acquisition was completed. For example, the SPAC's historical financial statements would not be required to be included in any filing after the first periodic filing (i.e., Form 10-K or Form 10-Q) of the combined entity.

In certain situations, a de-SPAC transaction may be structured such that a private operating company issues its shares and is the legal acquirer (e.g., a foreign operating company merging with a US domestic SPAC). In those cases, the new rules clarify that if a registrant will acquire or has acquired a shell company, the financial statements of the shell company (other than a business combination related shell company) are required to be included in any filing that requires the registrant's financial statements, unless the financial statements of the registrant include the period in which the acquisition was consummated.

The financial statements provided in a preliminary proxy statement or joint statement must be as of a date no earlier than 134 days before the date of the filing, except for third-quarter financial statements, which are timely through the 45th day after the most recent fiscal year end.[1] These financial statement age requirements also apply to the mailing date of a definitive proxy statement, the date of effectiveness for a joint statement and the filing date of a Super 8-K (as discussed below).

How we see it

Companies need to be aware of these age requirements to avoid triggering a delay in the transaction timeline. Delays may occur because audits of year-end financial statements may not be completed until after the third-quarter financial statements have gone stale. If this happens, a company can't amend its filings or make a new one because it doesn't have the required audited financial statements to include.

Illustration 1 — Financial statements to be included in the proxy statement or joint statement

ABC SPAC is a calendar year-end SPAC formed on 26 February 20X2 that completed its IPO on 5 May 20X2. Its IPO registration statement on Form S-1 included audited financial statements as of 2 March 20X2 and for the period from inception to that date. It intends to acquire XYZ Inc., a privately held calendar year-end operating company. XYZ Inc. would qualify as an EGC if it were conducting its own IPO.

Scenario 1 — Proxy statement is filed on 11 February 20X3 (before the filing of ABC SPAC's first annual report on Form 10-K)

	SPAC		Target company	
	Audited	Unaudited (1)	Audited	Unaudited
Balance sheet	As of 2 March 20X2	As of 30 September 20X2	As of 31 December 20X1 and 20X0	As of 30 September 20X2 (comparative to 31 December 20X1)
Statement of operations	For the period from 26 February 20X2 (inception) through 2 March 20X2	For the period from 26 February 20X2 (inception) through 30 September 20X2	For the years ended 31 December 20X1 and 20X0	For the nine months ended 30 September 20X2 and 20X1
Statement of changes in shareholders' equity and statement of cash flows	For the period from 26 February 20X2 (inception) through 2 March 20X2	For the period from 26 February 20X2 (inception) through 30 September 20X2	For the years ended 31 December 20X1 and 20X0	For the nine months ended 30 September 20X2 and 20X1

The proxy statement was filed on 11 February 20X3, before the 15 February 20X3 staleness date for third-quarter financial information. Because the SPAC and the target company (if it were conducting its own IPO) would qualify as EGCs, the SPAC can present two years of the target's audited financial statements.

(1) For proxy statements or joint statements filed before the due date of a SPAC's first annual report on Form 10-K, the registrant may file the same audited stub period that is in the SPAC's Form S-1, and periods subsequent to that balance sheet date may be reported on an unaudited basis unless the effective date of the registration statement is more than 45 days after the SPAC's fiscal year end.

Scenario 2 — Proxy statement is filed on 31 March 20X3 (after the filing of ABC SPAC's first annual report on Form 10-K)

	SPAC		Target company	
	Audited	Unaudited	Audited	Unaudited
Balance sheet	As of 31 December 20X2	N/A	As of 31 December 20X2 and 20X1	N/A
Statement of operations	For the period from 26 February 20X2 (inception) through 31 December 20X2	N/A	For the years ended 31 December 20X2 and 20X1	N/A
Statement of changes in shareholders' equity and statement of cash flows	For the period from 26 February 20X2 (inception) through 31 December 20X2	N/A	For the years ended 31 December 20X2 and 20X1	N/A

When the proxy statement is filed after the third-quarter financial information staleness date, the SPAC is required to include updated audited annual financial statements in the proxy statement. Consistent with Scenario 1, because the SPAC and the target company qualify as EGCs, only two years of the target company's financial statements are required. Any proxy statements or joint statements or amendments filed after 134 days from year end will need to be updated to include first-quarter comparative financial statements of both the SPAC and the target company.

While the targets of SPACs are usually privately held companies, they need to provide financial statements that comply with the form and content requirements of Regulation S-X and the US GAAP requirements of a public business entity (PBE, as defined in US GAAP) for use in the proxy statement or joint statement. Financial statements prepared in compliance with Regulation S-X (other than SRCs) require more disclosures on the face of the financial statements and in the notes to the financial statements to address various SEC rules, including:

- Identification of related party transactions on the face of the financial statements (Rule 4-08(k) of Regulation S-X)
- Balance sheet disclosure of required line items on the face of the financial statements (Rule 5-02 of Regulation S-X)
- Separate presentation of product, service, rental and other revenue on the face of the statement of comprehensive income (Rule 5-03(b) of Regulation S-X) and costs related to such revenue activities

Financial statement schedules required by Rule 5-04 of Regulation S-X (e.g., schedule of valuation and qualifying accounts) need to be included with the historical financial statements of the target company. Article 12 of Regulation S-X specifies the form and content of schedules. Target companies that have elected private company accounting alternatives are required to unwind this accounting and revise their financial statements before including them in a proxy statement or joint statement.

A target company that is considered the predecessor is also expected to provide public company accounting disclosures, such as disclosures required by US GAAP standards on segment reporting and earnings per share (EPS) in its financial statements.

How we see it

The SEC staff has not provided any special transition provisions for unwinding private company accounting alternatives, so target companies are required to retrospectively revise their financials from the date the private company accounting alternatives were elected. Unwinding these alternatives and adding public company accounting disclosures can significantly increase the time needed to produce audited target company financial statements.

Adoption of new accounting standards

The target company's financial statements generally must comply with new accounting standards as of the adoption date for PBEs. However, a target company may apply private-company adoption dates for new accounting standards if (1) the SPAC qualifies as an EGC and elected to take advantage of the extended transition period available to nonpublic entities for new accounting standards, (2) the target company would qualify as an EGC if it were to conduct its own IPO and (3) the combined company will continue to qualify as an EGC after the de-SPAC transaction.

Our ***Effective date matrix*** publication, which is updated quarterly, lists Accounting Standards Updates (ASUs) and their effective dates and provides links to related EY content. Target companies should carefully evaluate whether they qualify to use private-company adoption dates and determine which accounting requirements they need to apply in regulatory filings for a de-SPAC transaction.

Audit and review considerations

The financial statements of a target company that has been determined to be the predecessor entity in a de-SPAC transaction (including a private company) and included in the proxy statement or joint statement, must be audited in accordance with Public Company Accounting Oversight Board (PCAOB) standards by a registered accounting firm that is compliant with both PCAOB and SEC independence standards. However, the financial statements of a target company that is not the predecessor may be audited in accordance with the standards of the American Institute of Certified Public Accountants (AICPA).

When the financial statements of a non-issuer target company are audited in accordance with PCAOB standards, the auditor (if a member of the AICPA) would also be required to conduct the audit in accordance with AICPA standards pursuant to AICPA AU-C 700.44, and the report would reference the fact that the audit was performed under both the PCAOB standards and the AICPA standards (i.e., it would be a dual standards auditor's report).

While auditor's reports that refer to the PCAOB standards generally must communicate CAMs, this requirement does not apply to audits of EGCs. The SEC staff has indicated that CAMs can be omitted from the PCAOB auditor's report of a target company if (1) the target company would be an EGC if it were to conduct its own IPO of common equity securities and (2) the combined company will qualify as an EGC immediately after the de-SPAC transaction.

How we see it

Companies contemplating a de-SPAC transaction should understand the auditing requirements and plan accordingly. That's because additional audit work may be required to issue an auditor's opinion in accordance with PCAOB standards if the financial statements were previously audited in accordance with AICPA standards. Also, if the auditor that previously conducted the audit in accordance with AICPA standards is determined not to have been independent in accordance with SEC regulations for the fiscal year immediately preceding the initial filing of the registration statement or proxy, a change in auditor and a re-audit of the financial statements may be required.

Carve-out and abbreviated financial statements

If the target constitutes a legal entity or substantially all of a legal entity, the financial statements of that entity should be provided. If the target is a division or component of a business (or groups of businesses) that does not constitute substantially all of the selling entity, the SPAC would need to provide carve-out financial statements of the target business. The SEC staff generally will not accept abbreviated financial statements (i.e., statement of assets acquired and liabilities assumed and statement of revenues and direct expenses) for a predecessor entity.

In either case, an entity preparing carve-out financial statements must apply the staff guidance in Staff Accounting Bulletin Topic 1.B.1. For further discussion of these principles, refer to our publication, ***Guide to preparing carve-out financial statements***.

In financial statements of acquired businesses and target companies other than those of a predecessor (e.g., in transactions involving more than one target), Rule 3-05(e) of Regulation S-X allows registrants to provide abbreviated financial statements of an acquired

business that is part of a larger selling entity when certain conditions are met. For further discussion of these conditions, refer to our Technical Line, *Applying the SEC's requirements for significant acquired businesses*.

Cross-border considerations

If a foreign target is determined to be the predecessor in a de-SPAC transaction, the transaction is treated as the "backdoor" listing of the target through a reverse recapitalization with a domestic public shell. This would likely be the case, even if the SPAC were domiciled overseas but did not meet the definition of a foreign private issuer (FPI).

In these situations, the proxy statement or joint statement must include the financial statements of the target prepared using US GAAP because neither the SPAC nor the combined company would qualify as an FPI upon consummation. A foreign target would only be able to present its financial statements under IFRS as issued by the International Accounting Standards Board (IASB) in a de-SPAC transaction structured with the legal acquirer being either the target or a newly formed entity eligible to file on Form F-4.

If the transaction involves multiple targets and the foreign target has been determined not to be a predecessor and qualifies as a foreign business as defined by the SEC, reporting under a comprehensive basis other than US GAAP may be preferable to save time and effort that would otherwise be required to restate and re-audit the financial statements applying US GAAP. Financial statements of foreign businesses to be acquired may be prepared in accordance with IFRS as issued by the IASB or another comprehensive basis other than US GAAP.

If the financial statements are prepared in accordance with IFRS as issued by the IASB, they do not need to be reconciled to US GAAP. However, management will need to understand the differences to make appropriate pro forma adjustments to convert the target's historical financial statements to US GAAP for inclusion in the pro forma financial information. If the financial statements of a foreign business target are prepared on a comprehensive basis other than US GAAP or IFRS as issued by the IASB, they must be reconciled to US GAAP in accordance with the requirements of Item 17 of Form 20-F.

How we see it

Target companies in de-SPAC transactions face the same challenges as companies that conduct a traditional IPO because many of the disclosure and financial statement requirements for proxy statements and joint statements in these transactions are the same as those for IPO registration statements.

However, de-SPAC transactions require significant coordination between buyers, sellers and the target company's management, and their timeline is usually much shorter than that of traditional IPOs.

Pro forma financial information and transaction accounting

Pro forma financial information is required to be included in a proxy statement on Schedule 14A under Item 11 and in a joint registration and proxy statement on Form S-4 under Item 5. The pro forma financial information should be prepared in accordance with the age, form and content requirements of Article 11 of Regulation S-X.

Refer to our SEC Financial Reporting Series publication, ***Pro forma financial information — A guide for applying Article 11 of Regulation S-X***, for more information on the preparation of pro forma financial information.

To effectively prepare Article 11 pro forma information to be included in the de-SPAC transaction proxy or registration statement, the SPAC needs to reach conclusions on the accounting matters discussed below. These are only some of the more common accounting matters that SPACs and target companies should consider. Additional accounting issues may need to be considered.

Determining the accounting acquirer

While a SPAC legally acquires the private operating company, the accounting for the transaction depends on which entity is considered the acquirer for accounting purposes (i.e., the accounting acquirer).[2] The accounting acquirer is the entity that has obtained control of another entity (i.e., the acquiree). When a SPAC acquires a business for all cash consideration, the SPAC is usually the accounting acquirer. But if the consideration is equity or a mix of cash and equity, determining the accounting acquirer requires further evaluation and may be complex.

Like entities involved in other merger transactions, entities involved in de-SPAC transactions need to first consider the variable interest model in Accounting Standards Codification (ASC) 810-10, which requires the primary beneficiary of a variable interest entity (VIE) to consolidate the VIE in all instances. That is, if the acquiree is a VIE, the primary beneficiary will be the accounting acquirer. The factors in ASC 805-10-55-11 through 55-15 are not considered when applying the VIE model to determine the accounting acquirer. However, determining whether a target company is a VIE can be challenging.

The SEC staff frequently comments on the determination of the accounting acquirer when it reviews pro forma financial information.

If the VIE model doesn't apply, additional analysis may be needed to determine the party that has obtained a controlling financial interest in the combined entity and is therefore the accounting acquirer. This determination may require significant judgment. For example, the combined entities may be nearly equal in value, or the shareholders of one entity may not clearly control the combined entity based on voting interests (i.e., the acquirer is not obvious).

In these cases, the guidance in ASC 805-10-55-11 through 55-15 must be considered to determine the accounting acquirer. That guidance requires an evaluation of all the following factors that influence the identification of the acquirer:

- *Relative voting rights in the combined company* — Assuming none of the other factors indicates which entity is the acquirer, the entity whose owners, as a group, retain or receive the largest portion of the voting rights in the combined company is usually the acquirer. Because de-SPAC transactions often involve redemptions by selling shareholders that may affect the relative voting rights as well as complex equity structures (e.g., voting shares, non-voting shares, warrants, convertible instruments), these transactions require a careful analysis of the combined company's post-combination voting structure. If consideration paid for the target includes shares in the SPAC, the former owners of the target company may wind up holding the largest portion of voting rights in the combined company.

- *Existence and size of a single minority voting interest in the combined company* — Assuming none of the other factors indicates which entity is the acquirer, the entity with a large minority voting interest concentrated in one individual or entity, or a group of individuals or entities considered under common control, that has an ability to significantly influence the combined entity is generally the accounting acquirer. For instance, assume that a former shareholder of the private operating company (target) received 30% of the outstanding shares of the combined company and no other shareholder owns a significant interest. Assuming none of the other factors indicate which entity is the acquirer, the significant minority interest held by a former shareholder of the private operating company would favor the private operating company as the accounting acquirer.

- *Composition of the governing body* — Assuming none of the other factors indicates which entity is the acquirer, the entity whose continuing shareholders can elect or appoint a voting majority of the governing body is generally the accounting acquirer. A target's former owner that maintains an ownership interest in the combined company is typically given the power to initially appoint a certain number of the combined company's directors. The governance structure, including the term of the board appointment and how members of the board are elected or appointed should be considered. In addition, the entities should consider whether the governing body can make significant decisions affecting the operations of the combined company for a sufficient period of time.

- *Composition of management* — Assuming none of the other factors indicates which entity is the acquirer, the entity whose executive team dominates the management of the combined entity is generally the accounting acquirer. While management of the combined company comes from the target in most SPAC transactions, management domination may shift in the near-term as mandatory retirements occur and new management is appointed, or there could be a combination of new and continuing management. In these cases, the relative number of executive positions held by the target's and SPAC's former management teams, and the roles, responsibilities and seniority of the individuals, should all be considered.

- *Relative size of the combining companies* — Assuming none of the other factors indicates which entity is the acquirer, if one of the combining companies is significantly larger than the other (e.g., based on assets, revenue or earnings), that entity is generally the acquirer. Because the SPAC generally has only nominal operations, this factor usually points to the target as the accounting acquirer.

- *Terms of the exchange of equity interests* — Assuming none of the other factors indicates which entity is the acquirer, the entity that pays a premium over the pre-combination fair value of the shares of the other entity or entities is generally the accounting acquirer. However, this factor may be considered less significant because the target is usually a private operating company, and the fair value of its shares is difficult to objectively and reliably determine.

Some of the factors an entity is required to consider under ASC 805-10-55-11 through 55-15 may suggest that the SPAC is the accounting acquirer, while others may suggest that the operating company is the accounting acquirer. In these cases, significant judgment is required. Refer to section 3.2 of our Financial reporting developments (FRD) publication, ***Business combinations***, for further discussion of how to evaluate these factors.

This analysis is particularly important, as it will impact the accounting and financial statement presentation, which can differ significantly depending on which party is determined to be the accounting acquirer.

Also see our FRD, ***Consolidation***, for further guidance on applying the variable interest and voting interest models.

How we see it

Determining the accounting acquirer in a de-SPAC transaction may require careful analysis and significant judgment. Companies should consider preclearing their determinations with the SEC staff before filing their proxy statements or joint statements if the determination of the acquirer isn't clear.

If a SPAC is determined to be the accounting acquirer, the transaction is accounted for as a business combination in accordance with the guidance in ASC 805[3] (i.e., as a forward merger). The pro forma financial information included in the proxy statement or joint statement will reflect purchase accounting applied to the private operating company and will require a preliminary valuation of the private operating company's assets and liabilities.

If the private operating company is determined to be the accounting acquirer, the transaction is accounted for as a reverse recapitalization rather than as a business combination. That is, the accounting will be similar to that of a capital infusion because the only pre-combination asset of the SPAC is likely to be cash obtained from investors. Refer to section 3.2.2.2.5 of our FRD, ***Business combinations***, for further discussion.

Earn-out provisions in a business combination

A de-SPAC transaction agreement may include a provision for additional consideration to be transferred to the shareholders of the target company in the future if certain events occur or conditions are met (e.g., the combined company's earnings are greater than an agreed-upon target over a specified period of time, certain tax benefits are realized, the combined company's stock price reaches an agreed-upon value by a specified date). This additional consideration, commonly referred to as an "earn-out" payment, may be in the form of additional equity interests in the combined company, cash or other assets.

If the SPAC is identified as the accounting acquirer and the target company is a business, the earn-out payment may represent contingent consideration in connection with a business combination. While such payments may be negotiated as part of the de-SPAC transaction, the terms of the arrangement need to be evaluated to determine whether the payment is part of or separate from the business combination. In making this evaluation, the SPAC should consider the nature of the arrangement, the reasons for entering into the arrangement and which party receives the primary benefits from the transaction. If the arrangement is entered into primarily for the benefit of the SPAC or the combined company, rather than primarily for the benefit of the target or its former shareholders, the arrangement is likely a separate transaction that should be accounted for separately from the business combination. All facts and circumstances of a particular transaction should be evaluated when making this determination. Refer to section 3.4.1.2 of our FRD, ***Business combinations***, for further guidance on determining what elements of an arrangement are part of or separate from the business combination.

For example, payments are sometimes made to shareholders of the target company who will remain as employees of the combined company after the de-SPAC transaction. In this case, the SPAC must carefully evaluate whether the substance of the arrangement is to compensate the former shareholders for future services rather than to provide additional consideration in exchange for the acquired business. Refer to section 6.4.5 of our FRD, ***Business combinations***, for further guidance on determining whether contingent payments made to former shareholders of the acquiree are compensatory in nature.

If the SPAC determines that an earn-out provision represents consideration transferred for the acquired business, the contingent consideration is recognized at acquisition-date fair value under ASC 805. However, earn-out arrangements that represent separate transactions are accounted for under other applicable US GAAP. For example, payments made to former shareholders of the target company that are determined to be compensatory are accounted for as compensation expense for services provided in the post-de-SPAC-transaction period.

As discussed in the *Tax accounting considerations* section, the parties to a de-SPAC transaction may also enter into a tax receivable agreement (TRA) that requires the combined company to make future payments to the target's former shareholders when certain tax benefits are realized. As the accounting acquirer, the SPAC will need to carefully evaluate whether such payments represent contingent consideration for the acquired business.

If the private operating company is determined to be the accounting acquirer and the transaction is accounted for as a reverse recapitalization, earn-out payments made to the private operating company's former shareholders (including those that are made pursuant to a TRA) are accounted for in accordance with other US GAAP. See the *Accounting for financial instruments issued by SPACs* section and *Tax accounting considerations* section of this publication.

Accounting for financial instruments issued by SPACs

A SPAC issues several financial instruments during its life cycle, and they often become the combined company's financial instruments after the de-SPAC transaction.

At formation, the SPAC typically issues Class B shares (referred to as founder shares) to the SPAC sponsor and its affiliates in return for forming the SPAC. The SPAC sponsor and its affiliates may also purchase warrants (i.e., private warrants) from the SPAC to acquire Class A shares. Upon its IPO, the SPAC will issue units consisting of Class A shares and warrants (i.e., public warrants) to third-party investors.

And finally, upon the de-SPAC transaction, the SPAC generally will issue additional Class A shares to the selling shareholders of the target company and will typically enter into arrangements with the selling shareholders, the SPAC sponsor and/or employees of the target (i.e., earn-out arrangements) to issue additional shares if, during a specified period after the de-SPAC transaction, its stock price equals or exceeds specified amounts or upon the occurrence of certain liquidity events (e.g., change of control of the combined company, sale of substantially all of the assets of the combined company).

The Class A shares, Class B shares, and the public and private warrants (collectively, the warrants) are generally each considered freestanding financial instruments because they are either issued separately and apart from each other or, if they are issued in conjunction with each other, they are legally detachable and separately exercisable. In addition, earn-out arrangements are typically considered freestanding financial instruments because they are issued upon the de-SPAC transaction, separately and apart from other instruments.

Each financial instrument must be evaluated to determine its appropriate accounting treatment. Any financial instrument issued as part of a share-based payment arrangement must be accounted for in accordance with ASC 718.[4]

The following discussion primarily focuses on the classification of these instruments in the financial statements of the combined company upon the de-SPAC transaction. For more information on the accounting for financial instruments issued by SPACs, refer to our Technical Line, ***A closer look at accounting for financial instruments issued by SPACs***.

Class A and Class B shares

If the shares are not subject to ASC 718, because the legal form of Class A and Class B shares is equity, they first have to be evaluated under ASC 480[5] to determine whether they should be classified as liabilities.

ASC 480 applies to certain freestanding financial instruments. While ASC 480 does not define an equity instrument or a liability, it does require three types of freestanding instruments to be classified as liabilities (or assets in some cases), including:

- Shares that are mandatorily redeemable
- Financial instruments other than a share that represent or are indexed to obligations to repurchase the issuer's equity shares by transferring assets
- Certain obligations to issue a variable number of shares

If an instrument is classified as a liability under this guidance, it generally will be measured at fair value with changes in fair value recognized in earnings.

The Class A and Class B shares generally are not liabilities because they are not mandatorily redeemable and don't represent an unconditional obligation to issue a variable number of equity shares where the monetary value of the obligation is based solely or predominantly on (1) a fixed amount, (2) variations in something other than the fair value of the SPAC's equity shares or (3) variations that move in the opposite direction to changes in fair value of the SPAC's equity shares.

However, since a SPAC is an SEC registrant, it must consider the SEC staff's guidance in ASC 480-10-S99-3A on redeemable equity securities. Because the Class A shares contain redemption rights that make them certain to become redeemable by the holder and no exceptions in ASC 480-10-S99-3A apply, the Class A shares must be classified in temporary equity in the SPAC's financial statements and are subject to the subsequent measurement guidance in ASC 480-10-S99-3A. Once the SPAC successfully completes a de-SPAC transaction with a target, the redemption features of the Class A shares terminate. At that time, the Class A share should be reclassified into permanent equity of the combined company.

The governing documents of SPACs typically do not permit a redemption of the Class A shares if it would cause the company's net tangible assets to decline below a certain threshold (i.e., less than $5 million). Some SPACs classified a portion of the Class A shares in permanent equity, partially because they viewed the unit of account to be the pool of the Class A shares, not the individual share. At the 2021 AICPA and CIMA Conference on Current SEC and PCAOB Developments,[6] the SEC staff clarified its view that each share should be presented outside of permanent equity and said that it disagrees with the view that the pool of the class of shares is the unit of account rather than each individual share. An entity should consider the staff's view when evaluating whether to classify its Class A shares in temporary or permanent equity.

The Class B shares are generally not redeemable by the holder and, as such, are not subject to the guidance in ASC 480-10-S99-3A.

Warrants

Warrants may be issued to the SPAC's employees or third-party service providers as compensation for services provided. In that case, ASC 718 should be considered.

If the warrants are not accounted for under ASC 718, they should be assessed under ASC 480 and ASC 815-40[7] to determine whether they should be classified as equity or liabilities.

Both the public and private warrants generally meet the definition of a freestanding financial instrument and should first be analyzed under the guidance in ASC 480 to determine whether they should be classified as liabilities under that guidance.

As discussed above, the Class A shares underlying the public and private warrants are redeemable by the holder for a period of time before the de-SPAC transaction. If the warrants are exercisable while the Class A shares are redeemable, those warrants are classified as liabilities pursuant to ASC 480-10-25-8 because they represent financial instruments that are not shares and they embody obligations to repurchase the issuer's equity shares by transferring assets. If the warrants can only be exercised after such redemption rights lapse, those warrants would not be liabilities under that guidance. The warrants generally also do not represent an obligation to issue a variable number of shares whose monetary value is based solely or predominantly on (1) a fixed amount, (2) variations in something other than the fair value of the Class A shares or (3) variations that move in the opposite direction to changes in fair value of the Class A shares. As such, they would also not be liabilities under ASC 480-10-25-14.

If the warrants are not classified as liabilities under ASC 480, they are evaluated under the guidance in ASC 815-40 to determine whether they should be classified as liabilities or equity.

ASC 815-40 requires an equity contract to both (1) be indexed to the issuer's stock under ASC 815-40-15[8] and (2) meet the requirements of the equity classification guidance in ASC 815-40-25,[9] in order to be classified as equity. If the warrants meet both of these criteria, they are classified in equity. Warrants that are not indexed to an entity's own stock or do not meet the equity classification criteria in ASC 815-40-25 are classified as liabilities.

The SEC staff issued a **statement** that said certain warrants issued by a SPAC should be classified as liabilities rather than as equity and highlighted the potential accounting implications. An entity should consider this statement when evaluating the appropriate classification of its warrants.

Earn-out arrangements

As discussed above, earn-out arrangements may be issued to the employees of the target as part of the de-SPAC transaction negotiation. For those arrangements, ASC 718 should be considered. See further discussion in the *Stock-based compensation* section below.

Earn-out arrangements entered into with the selling shareholders and the SPAC sponsor generally are not classified as liabilities under ASC 480 because they do not represent obligations that must or may be settled by transferring assets or obligations to issue a variable number of shares that meet one of the conditions described in ASC 480-10-25-14.

Earn-out arrangements may need to be classified as liabilities.

If an earn-out arrangement is not an ASC 480 liability, it should be evaluated under the indexation guidance (ASC 815-40-15) and the equity classification guidance (ASC 815-40-25) to determine whether it should be classified as a liability or equity.

It is typical for an earn-out arrangement to have share-price triggers. For example, an earn-out arrangement may require the combined entity to issue an additional 1,000,000 shares to selling shareholders if the volume-weighted average price (VWAP) of the combined entity exceeds $15 per share during a certain timeframe and an additional 1,000,000 shares if VWAP exceeds $20 per share during the same timeframe. It is also typical that an earn-out arrangement contains provisions that change the settlement amount for other reasons (e.g., a change of control of the combined company). These early settlement provisions effectively adjust the number of shares to be issued (which is otherwise determined based on share-price triggers) under the earn-out arrangement.

Entities evaluating these arrangements should pay particular attention to features that adjust the settlement amount, because some adjustment features can preclude the earn-out arrangement from being considered indexed to an issuer's stock under ASC 815-40-15 and require liability classification. Generally, when the settlement amount of an earn-out arrangement changes based on stock price, the arrangement may be considered indexed to an entity's own stock. But provisions that change the settlement amount for other reasons (e.g., a change of control provision that entitles the holder to all remaining unearned shares under the arrangement regardless of stock price) may preclude the arrangement from being indexed to the entity's own stock.

If the earn-out arrangement is considered indexed to the entity's own stock under ASC 815-40-15 and also meets the equity classification guidance in ASC 815-40-25, the earn-out arrangement will be classified in equity. If an earn-out arrangement does not meet the indexation guidance or the equity classification guidance, the earn-out arrangement will be classified as a liability.

Analysis of earn-out arrangements in the form of legally outstanding shares

Some earn-out arrangements with SPAC sponsors may be structured in the form of legally outstanding shares. Those shares typically are issued before the de-SPAC transaction but are modified as part of the de-SPAC transaction to become forfeitable or subject to certain

transfer restrictions. Those forfeiture requirements and transfer restrictions typically are removed upon the attainment of certain share price levels or the occurrence of a specified event (e.g., change of control).

The accounting guidance for legally outstanding shares differs from the accounting for contracts to issue an entity's own equity. Nevertheless, combined companies should consider the substance of these types of shares. If the legally issued shares do not have substance as shares (e.g., they have no dividend rights or voting rights, they are forfeitable after a period of time unless a certain share-price level is achieved or a specified event occurs), the combined company should evaluate the arrangement under the guidance for contracts in an entity's own equity (ASC 480 and ASC 815-40). That is, because the shares lack substance and are more akin to the earn-out arrangements described above, the same analysis should be followed.

If the earn-out arrangement is accounted for in part under ASC 718 (e.g., earn-out shares are issuable to both selling shareholders and employees), further analysis is required. See further discussion in the *Stock-based compensation* section below.

Stock-based compensation

When an earn-out arrangement is made with an ASC 718 grantee (e.g., an employee who holds vested and/or unvested options) that could result in the grantee receiving additional share-based payments if the combined company achieves a specified VWAP, the combined company should determine whether the earn-out arrangement is compensatory and in the scope of ASC 718. If the earn-out is subject to ASC 718, the award contains a market condition because the number of earn-out shares issued is contingent upon the combined entity achieving a specified share price.

If the SPAC is determined to be the accounting acquirer, the entity should consider whether the earn-out is subject to the replacement award provisions of ASC 805 or is a new award under ASC 718. If the private operating company is determined to be the accounting acquirer and the transaction is accounted for as a reverse recapitalization, the entity should determine whether the earn-out represents a change to share-based payment arrangements that requires modification accounting under ASC 718 or a new award under ASC 718 in connection with the transaction.

For more information, refer to our FRD publication, ***Share-based payment***.

Reallocation of forfeitable shares

Earn-out arrangements may be granted to both employees and selling shareholders. If employees are required to provide services to participate in the earn-out, their earn-out is in the scope of ASC 718. The combined entity should determine how any forfeiture of employees' earn-out shares could affect the number of shares issuable to the remaining employees and/or to selling shareholders (whose arrangement is accounted for under ASC 815-40).

If the settlement amount of the earn-out arrangement with the selling shareholders is adjusted based on employment status (e.g., employees' forfeited shares are reallocated to the pool of earn-out shares to be issuable to selling shareholders who are not employees), that arrangement may not be considered indexed to an entity's own stock under ASC 815-40 (refer to the *Earn-out arrangements* section above for more information). If forfeited shares are reallocated to ASC 718 grantees, this is considered a "last-man-standing" arrangement, and the forfeiture and subsequent reallocation of the earn-out shares are accounted for as the forfeiture of the original award and the grant of a new award.

‘Cheap stock’

With de-SPAC transaction valuations in many cases significantly exceeding the fair value of equity securities of private target companies shortly before the de-SPAC transaction (resulting in the pre-de-SPAC-transaction grants being called “cheap stock”), the SEC staff may challenge the fair value of share-based payments issued before the de-SPAC transaction.

Management has to support its judgments and estimates about the fair value of its securities anytime it grants significant share-based payments and should retain documentation about such estimates, preferably contemporaneous documentation. The SEC staff generally presumes that the public price provides the best relative indication of fair value. The SEC staff may ask about the reasons for valuations of equity securities in the financial statement periods before the de-SPAC transaction if the fair value is significantly lower than the exit event price.

The AICPA’s Accounting and Valuation Guide, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation* (the Guide), provides a framework and describes best practices for valuing private company securities. The SEC staff expects companies contemplating entering the public markets to apply the Guide’s valuation guidance when valuing share-based payments they grant (and other equity instruments) in the periods before the potential transaction.

For more information on cheap stock, refer to our Technical Line, ***Reminders about ‘cheap stock’ issues for companies going public in IPOs and SPAC mergers***.

Earnings per share

ASC 260 requires the presentation of EPS by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of common stock or potential common stock in a public market. Potential common stock includes securities such as options, warrants, earn-out provisions and share-based payment arrangements that entitle the holders to obtain the entity’s common stock at a future date.

As discussed above, the SPAC and the companies it merges with may enter into arrangements that involve various financial instruments, such as warrants, earn-out provisions and share-based payments that require the entity to issue common stock to settle these contracts. The computation of EPS can be challenging, depending on the complexity of an entity’s capital structure. Our FRD, *Earnings per share*, provides interpretative guidance on the computation, presentation and disclosure of EPS. Refer to the following sections of our EPS FRD for further discussion about common challenges when computing basic and diluted EPS:

- Participating securities and the two-class method — Entities that have multiple classes of common stock or have issued securities other than common stock that participate in dividends with common stock (i.e., participating securities) are required to apply the two-class method to compute EPS (section 5).
- Options, warrants and their equivalents — These instruments are excluded from the computation of basic EPS, but the dilutive effect is generally calculated using the treasury stock method (section 4.3).
- Redeemable equity securities — Subsequent measurement adjustments recorded pursuant to ASC 480-10-S99-3A related to redeemable instruments are treated in the same manner as dividends on nonredeemable stock and may affect income available to common shareholders (i.e., the EPS numerator). The manner in which subsequent adjustments affect EPS depends on whether the redeemable securities are common stock or preferred stock, and if they are common stock (most common in SPAC structures), whether the redemption value is at fair value or at an amount other than fair value (section 3.2.2).

- Share-based payment arrangements — These arrangements have several unique characteristics that can have a significant effect on EPS (section 4.4).
- Contingently issuable shares — Shares that are issuable for little or no cash consideration upon the satisfaction of certain conditions (e.g., earn-out arrangements) are included in basic EPS only if all the necessary conditions to issue such shares have been satisfied by the end of the period and there is no circumstance under which those shares would not be issued. Determining the effect of such shares on diluted EPS can be complex (sections 3.3.2 and 4.8).
- Contracts that may be settled in stock or cash — The numerator may need to be adjusted for changes in income or loss that would result from the assumed settlement of the contract in cash or shares (section 4.9 and 4.9A).

We also discuss common EPS considerations in SPAC transactions in our Technical Line, ***A closer look at accounting for financial instruments issued by SPACs***.

Tax accounting considerations

Accounting for the tax consequences of a de-SPAC transaction is often complex. Companies will need to involve tax professionals to help them identify the income tax accounting consequences of a de-SPAC transaction.

In a transaction that is a reverse recapitalization for financial statement purposes, the legal acquirer's or parent's (i.e., the "combined entity" for periods after the transaction) financial reporting basis of the ownership interest in the target is based on the historical carrying value of the private operating company. Depending on how the de-SPAC transaction is structured, the combined entity may obtain a step-up in the tax basis in the interest it receives in the target company. As a result, this transaction generally will result in a deductible outside temporary basis difference as the combined entity's tax basis will be greater than its financial reporting basis in the private operating company.

In a transaction accounted for as a reverse recapitalization, the offsetting amount (e.g., a deferred tax asset) would be recorded as an adjustment to additional paid-in capital. This is consistent with the guidance in ASC 740-20-45-11(g) that requires the tax effects of changes in tax bases caused by transactions among shareholders to be included in equity. If a deferred tax asset is recorded, by the legal acquirer or parent, the company will need to determine whether the deferred tax asset is realizable. If a valuation allowance is initially required, the tax accounting effects of recording a valuation allowance should also initially be recorded in equity. Changes in valuation allowances in subsequent periods (increase or decrease) would be included in the income statement.

In transactions accounted for as a business combination, the combined entity's financial reporting basis in the target is recorded at its fair value at the date of the de-SPAC transaction. Depending on the tax treatment of the de-SPAC transaction, this could result in the financial reporting basis in the private operating company differing from the tax basis, resulting in a deductible or taxable temporary difference. Additional income tax accounting complexities may arise as the assets acquired and liabilities assumed will be recorded at their fair value and the transaction may give rise to goodwill (book and/or tax). For additional information on the accounting for the tax effects of a business combination, see section 11 of our FRD, ***Income taxes***.

Under the guidance in ASC 740-30, the combined entity recognizes a deferred tax asset for the deductible outside basis difference that arises from the transaction only if it is apparent that the deductible temporary difference will reverse in the foreseeable future. If a taxable temporary difference arises from the transaction, a deferred tax liability is recognized, unless

the combined entity could apply one of the recognition exceptions in ASC 740-30 (e.g., its net investment is essentially permanent in duration or can recover the investment tax-free). However, if the private operating company is a partnership or other pass-through entity, the exceptions for recognizing deferred taxes for outside basis differences noted above are not available, and the related deferred tax asset or liability must be recognized at the date of the de-SPAC transaction. For additional information on the accounting for tax effects of outside basis differences in partnerships and other pass-through entities, see section 14, of our FRD, ***Income taxes***.

It is common for a target operating entity that historically operated as a partnership or limited liability corporation (LLC) to use an umbrella partnership corporation structure (Up-C) when it contemplates going public by merging with the SPAC. For additional information on tax accounting considerations for Up-C structures, see section 14.7, of our FRD, ***Income Taxes***.

Tax receivable agreements

In SPAC transactions involving private operating companies that are treated as partnerships or similar pass-through entities for income tax purposes, it is common for the owners of the private operating company to enter into an agreement with the SPAC to share the tax benefits that the combined entity may receive from a tax basis step-up resulting from the transaction. These arrangements, commonly referred to as TRAs, permit the target company owners to receive payments for the reduction in cash taxes otherwise due by the combined entity as a result of the tax basis created on exchanges by the legacy target company owners. The amount paid to the target company's former owners is typically 85% of the income tax savings realized by the combined entity, but the amount may vary so it is important to evaluate the provisions of each arrangement.

In addition, when payments are made under the TRA, such payments for income tax purposes are also treated as additional purchase price in connection with the initial exchange of partnership equity (or similar pass-through entity equity), resulting in an additional step-up in tax basis, which generates additional future TRA payments (i.e., an iterative result). The measurement of the expected future tax benefits and related TRA obligation often is complex, and tax professionals should be involved.

In a reverse recapitalization, the combined entity generally will recognize a liability to former shareholders based on the future expected payments to be made under the terms of the TRA arrangement. Because the payout usually is contingent on the combined entity realizing tax savings from a step-up in tax basis, the liability is generally recognized when it is probable of being paid and the payout amount is reasonably estimable based on the guidance in ASC 450.

While the liability for the TRA arrangement is in the scope of ASC 450, we believe that it would generally be acceptable to record a liability to the former shareholders when the tax benefits are determined to be realizable under ASC 740. For example, if the combined entity concludes that a valuation allowance is not required for deferred tax assets related to the step-up, a TRA liability would generally be recognized. Conversely, if the combined entity determines that a valuation allowance (or partial valuation allowance) is required for the related deferred tax asset(s), the TRA liability would generally not be recognized (or would be partially recognized).

When the transaction is accounted for as a reverse recapitalization, the offsetting amount of the TRA liability is recognized as an adjustment to paid-in capital.

Subsequent changes in the TRA liability resulting from increases or decreases in the valuation allowance are recognized in the income statement before income taxes and the related changes in the valuation allowance are included as a component of income tax expense (i.e., the amounts are reported gross and not offset against each other).

Depending on facts and circumstances, we understand that there are other approaches in practice for evaluating when a TRA liability should be recognized, and we have not objected to the use of other approaches that are consistent with the guidance in ASC 450.

See the *Earn-out provisions in a business combination* section of this publication for guidance on the accounting for TRA payments made by the combined entity to former shareholders of the target company when the SPAC is determined to be the accounting acquirer.

Other matters

Preparing the pro forma financial information requires careful consideration of all of the significant accounting issues expected to be encountered during the transaction and often requires companies to analyze and conclude on the accounting issues well in advance of the transaction closing. As discussed earlier, unwinding private company alternatives and adding public company accounting disclosures may be complex and may require significant judgment. Other common matters include:

- *Carve-out adjustments* — In cases where a registrant acquires or succeeds to substantially all of the key operating assets of an entity, the registrant will provide full audited financial statements of the entity. Specific assets and liabilities not acquired or assumed by the registrant would be adjusted in the Article 11 pro forma financial information. These adjustments are usually derived in a manner consistent with the preparation of carve-out financial statements.
- *IFRS and foreign currency translation* — While the financial statements of non-predecessor foreign targets that are prepared in accordance with IFRS as issued by the IASB do not need to be reconciled to US GAAP when they are included in the proxy statement or joint statement, any adjustments necessary to convert those financial statements to US GAAP should be reflected and disclosed in the pro forma financial information. Such adjustments may be reflected in a separate column or as part of the de-SPAC transaction adjustments. Similarly, the pro forma financial information should include and disclose any required currency translation adjustments to financial statements denominated in a different currency than that of the registrant.

Multiple pro forma presentations

Because the SPAC's public shareholders have the right to redeem their shares for a pro rata portion of the proceeds held in the trust account if they do not wish to invest in the proposed target(s), the pro forma financial information may need to consider both (1) a minimum redemption scenario, in which no shares are redeemed by public shareholders, and (2) a maximum redemption scenario. The differences can be presented in separate pro forma presentations or as footnote-only disclosures to the pro forma financial information, if the minimum or maximum outcome does not have a pervasive effect on the financial statements.

Certain public shareholders, typically affiliates of the sponsors, may waive their redemption rights. Such arrangements should be reflected in the maximum redemption scenario in the pro forma financial information.

The pro forma information for the maximum redemption scenario should reflect any backstop financing needed to fund a shortfall in cash available to complete the transaction caused by shareholder redemptions. As discussed earlier, backstop financing can take several forms.

In some cases, backstop financing a SPAC arranges in advance won't cover the shortfall that would result from the redemption of all public shares in the SPAC. If that's the case, the maximum redemption scenario in the pro forma financial information should reflect the maximum number of redemptions that could occur without causing the transaction to be

terminated. When considering the maximum redemption scenario, SPACs should pay close attention to the sources and uses of cash presented in the pro forma financial information. That is, cash reflected on the balance sheet of the target is not available to fund the transaction, including both the purchase and redemption of SPAC shares.

How we see it

Companies involved in de-SPAC transactions should be aware of the accounting implications of backstop arrangements, particularly those involving the former owners of the target or their affiliates.

In certain situations, exercising a backstop financing arrangement could change the accounting treatment (i.e., forward merger or reverse recapitalization) of the transaction. If that's the case, a SPAC would have to account for the transaction differently in the minimum and maximum redemption scenarios, and both treatments would need to be reflected in the pro forma financial information.

Other proxy statement or joint statement items

In addition to the financial statements, pro forma financial information and the nonfinancial disclosures discussed above, the proxy statement or joint statement is required to include MD&A of financial condition and results of operations for both the SPAC and the target(s).

The proxy statement or joint statement will also include disclosures related to risk factors; quantitative and qualitative disclosures about market risk, business, directors and executive officers; and compensation of directors and executive officers that are similar to those provided in an annual report on Form 10-K or an annual meeting proxy statement. For further discussion of these disclosures, refer to our SEC Financial Reporting Series publications, ***SEC annual reports — Form 10-K*** and ***Proxy statements: an overview of the requirements and observations about current practice***.

Information disclosed in the proxy statement or joint statement is frequently incorporated by reference into or included in the Super 8-K filing the combined company is required to file shortly after the de-SPAC transaction (see further discussion below) to provide financial information of the target(s) similar to what would be provided if the target company were to file its own registration statement on Form 10. The staff of the SEC Division of Corporation Finance released CF Disclosure Guidance: Topic No. 1, ***Staff Observations in the Review of Forms 8-K Filed to Report Reverse Mergers and Similar Transactions***, which provides reminders on the required content of these filings and areas of frequent staff comment. Companies are encouraged to review this guidance when preparing proxy statement or joint statement disclosures in advance of the Super 8-K filing.

Management's discussion and analysis

MD&A should comply with the requirements of Item 303 of Regulation S-K for the SPAC and target(s) for all periods presented in the financial statements. In de-SPAC transactions, the SEC staff often also asks companies to provide MD&A disclosures identifying any significant elements of historical income or loss that will not continue in the company's post-transaction operations.

For further discussion of MD&A preparation requirements, refer to our SEC Financial Reporting Series publications, ***SEC annual reports — Form 10-K*** and ***SEC quarterly reports — Form 10-Q***.

Filing review and comment process

Because de-SPAC transactions often result in a private operating company becoming a publicly traded entity, the SEC staff will generally review proxy statements and joint statements related to such transactions. The SEC staff has a target of issuing comments on such filings within 30 days and subsequent rounds of comments on amendments more quickly than that (generally 10 days). SPACs can expect to receive a few rounds of SEC staff comments before the definitive proxy can be filed and distributed or a joint statement can be declared effective and distributed. Most SPACs complete the SEC filing review and comment process for their proxy statements or joint statements over a period of several months, similar to the review period for traditional IPO registration statements.

In some instances, an initial draft Form S-4 may be eligible for non-public review by the SEC staff if it is submitted within 12 months of the SPAC's IPO for the first draft of the registration statement only. A SPAC that is submitting a registration statement for non-public review may omit annual and interim financial information that it reasonably believes it will not be required to present separately at the time the registration statement is filed publicly. Subsequent amendments must be filed publicly.

In addition to transaction-specific comments, SPACs often receive comments about the same topics as other companies. Refer to our ***Highlights of trends in SEC staff comment letters*** publication for a discussion of these topics.

Companies should pay close attention to the financial statement staleness dates when considering SEC staff comments. That's because significant effort and lead time is required to update the financial statements and related disclosures, as well as for any audits and post-report review procedures that auditors may need to complete.

How we see it

Companies involved in de-SPAC transactions need to remember that the SPAC is required to distribute prospectus and proxy and information statements filed in connection with the de-SPAC transaction to investors at least 20 calendar days before the shareholder vote. This requirement adds a step to the SPAC process that does not exist in a traditional IPO.

Super 8-K requirements

Within four business days of completing a de-SPAC transaction, the combined company must file a Form 8-K, referred to as a Super 8-K, that includes disclosures under:

- Item 2.01 Completion of Acquisition or Disposition of Assets
- Item 5.01 Changes in Control of Registrant
- Item 5.06 Change in Shell Company Status
- Item 9.01 Financial Statements and Exhibits

The disclosure requirements of Items 2.01 and 5.01 include, for the predecessor target, all of the information that would be required if the company were filing a Form 10 registration statement. Many of the disclosures in the Super 8-K would be identical to those in the proxy statement or joint statement, and the combined company may be able to incorporate them by reference to one of those filings. However, the combined company may need to update the financial statements and related disclosures due to age requirements.

If the target company (as the predecessor) qualifies as an EGC at the time the Super Form 8-K is filed, audited financial statements of the target company would not need to be presented for any period prior to the earliest audited period presented in the financial statements included in the de-SPAC registration or proxy statement.

The Super 8-K typically also includes disclosures under Item 4.01 Changes in Registrant's Certifying Accountant. That's because the SEC staff believes reverse recapitalization transactions always trigger such a reporting obligation, unless the same auditor reported on the most recent financial statements of both the SPAC and the target company and will continue to report on the combined company. This requirement is also triggered in forward mergers when a SPAC and an operating company have different auditors, and the registrant (i.e., the SPAC) engages the auditor of the operating company to be the auditor of the combined company. Refer to our SEC Financial Reporting Series publication, ***Proxy statements: an overview of the requirements and observations about current practice*****,** for a discussion of this requirement.

The disclosure of a change in accountants during the two most recent fiscal years or any subsequent interim period relating to a non-reporting target is not required in a proxy statement or joint statement, but the disclosure could be provided if the information was believed to be material. However, the disclosures set forth in Item 304(b) of Regulation S-K regarding disagreements with the target's auditors would be required in a proxy statement or joint statement.

Companies must file a Super 8-K within four business days after the completion of the de-SPAC transaction.

The staff of the SEC Division of Corporation Finance released CF Disclosure Guidance: Topic No. 1, ***Staff Observations in the Review of Forms 8-K Filed to Report Reverse Mergers and Similar Transactions,*** which provides reminders on the required content of these items and areas of frequent staff comment. Companies are encouraged to review this guidance.

The 71-day due date extension for financial statements typically available for business combinations under Item 9.01 does not apply to de-SPAC transactions.

Updating target company financial statements on Form 8-K

If the de-SPAC transaction closes after the target's most recently completed reporting period but well before the staleness date of the previous period's financial statements, the Super 8-K is usually filed with the previous period's financial statements because the financial statements for the most recently completed reporting period continue to be of the requisite age. See the *Age and content of financial statements* section above for more information.

If the de-SPAC transaction closes after the staleness date of the previous financial statements included in the proxy/registration statement, the Super 8-K reporting the close of the transaction would have to include more recent interim or annual financial statements, as applicable, and associated MD&A discussion for the predecessor.

If the de-SPAC transaction closes shortly before the staleness date of the previous financial statements included in the proxy/registration statement, the registrant would ordinarily include in the Super 8-K the same financial statements as in the proxy/registration statement. The registrant must then file an amended Form 8-K with the target's financial statements for the most recently completed reporting period and related MD&A. The due date of such amended Form 8-K depends on the SPAC's filer status. The amended Form 8-K would be due within 90, 75 and 60 days of period end for annual periods and 45, 40 and 40 days for interim periods if the SPAC is a non-accelerated, accelerated and large accelerated filer, respectively.

Illustration 2 — Due date for updating target company financial statements
ABC SPAC, a non-accelerated filer, acquires XYZ Inc., a calendar-year company, in a business combination on 27 January 20X3. It files its Super 8-K four business days later, on 31 January 20X3. The Super 8-K filing includes the unaudited financial statements of XYZ Inc. as of and for the nine months ended 30 September 20X2. These financial statements do not go stale until 14 February 20X3. ABC SPAC is required to file an amended Form 8-K with the audited financial statements of the target as of and for the year ended 31 December 20X2 by 31 March 20X3 (31 December 20X2 + 90 days). ABC SPAC is also required to separately file its annual report on Form 10-K, which includes its standalone financial statements for the year ended 31 December 20X2, by 31 March 20X3. The first periodic report reflecting the de-SPAC transaction would be the quarterly report on Form 10-Q for the quarter ended 31 March 20X3.

The pro forma financial information and related disclosures in the proxy statement or joint statement also should be updated to reflect the actual redemptions and any other preliminary information that was finalized as a result of the transaction.

How we see it

Companies involved in de-SPAC transactions need to be aware of Super 8-K disclosure requirements, including the deadline for making the filing. They also should monitor the expected transaction closing date to make sure they have enough time to prepare the filing and make any necessary updates to the financial statements and pro forma financial information.

Post-de-SPAC transaction considerations

Post-transaction Securities Act offerings

After a de-SPAC transaction closes, the combined company will typically file a registration statement on Form S-1 to register shares that will be issued when the warrants issued in the SPAC's IPO are exercised and any other outstanding and unregistered shares.

Companies emerging from de-SPAC transactions usually do not qualify for the use of Form S-3 because the combined company lacks a 12-month history of Exchange Act reporting. The SEC staff addressed this matter in **Question 115.18** of the Division of Corporation Finance Compliance and Disclosure Interpretations (C&DI) on Security Act Forms.

When eligible, companies may file a shelf registration statement on Form S-3 and related prospectus supplements to consummate follow-on equity offerings for general corporate purposes. However, companies emerging from de-SPAC transactions cannot qualify as well-known seasoned issuers for three years following a change in shell company status (de-SPAC transaction). This means that any shelf registration statement filed on Form S-3 is subject to SEC staff review and must be declared effective, unlike an automatic shelf registration statement filed by a well-known seasoned issuer.

If the registration statement is filed before a periodic report that reflects the de-SPAC transaction, no new financial information should be required. However, if the de-SPAC transaction was accounted for as a reverse recapitalization and the registration statement is filed after the filing of such a periodic report, it would require recasting the target's prior annual financial statements to reflect the recapitalization in the subsequent de-SPAC transaction.

As noted in the *Age and content of the financial statements* section above, the historical financial statements of the SPAC do not need to be included in any filing once the financial statements of the target have been filed for all required periods through the acquisition date and the financial statements of the registrant include the period in which the de-SPAC transaction was consummated (i.e., the registration statement is filed after the filing of the periodic report reflecting the de-SPAC transaction).

Post-transaction Exchange Act reporting

After the closing of the de-SPAC transaction, the combined company is a publicly traded company and is responsible for complying with ongoing Exchange Act filing requirements.

Financial statement presentation and disclosures following a forward merger

After the de-SPAC transaction, the historical financial statements of the predecessor become the financial statements of the combined company. The SEC staff's guidance on the presentation of predecessor financial information is included in Section 1170.2 of the Division of Corporation Finance's Financial Reporting Manual (FRM).[10]

In a forward merger (i.e., a business combination), because a SPAC generally has nominal operations before the combination, the target company is usually designated as the predecessor of the combined company. The application of purchase accounting to the financial statements of the target in a forward merger results in a new basis of accounting to be reflected in the successor's financial statements after the transaction. To emphasize the change in reporting entity, the successor and predecessor periods would be separated by a black line in the standalone financial statements, similar to the presentation in the standalone financial statements of an acquiree after a business combination when pushdown accounting is applied.

For example, if the de-SPAC transaction occurred on 30 September, the 31 December statements of operations, comprehensive income, cash flows and changes in shareholders' equity would include a nine-month predecessor period and a three-month successor period, separated by a black line. The columns associated with each of these periods generally would be labeled "Predecessor Entity" and "Successor Entity" or something similar. In addition, the notes to the financial statements would reflect the relevant information for the predecessor and successor periods. The notes to the financial statements also would clearly discuss the basis of presentation as a consequence of the transaction.

The financial statement footnotes should also include the traditional business combination and pro forma disclosures required under ASC 805. Refer to section 8 of our FRD, ***Business combinations***, for a discussion of these disclosures.

Financial statement presentation and disclosures following a reverse recapitalization

Reverse recapitalizations do not result in a new basis of accounting, and the financial statements of the combined company represent a continuation of the financial statements of the target in many respects. However, the reverse recapitalization triggers unique accounting with respect to the entity's equity accounts, EPS and transaction costs.

Shareholders' equity of the accounting acquirer is presented as the equity of the combined company as follows:

- *Capital stock* — The capital stock account of the target is carried forward in a reverse recapitalization. However, the balance is adjusted to reflect the par value of the outstanding capital stock of the SPAC, including the number of shares the SPAC issued to effect the acquisition. Any corresponding offset is recognized as an adjustment to the additional paid-in capital account.

- *Additional paid-in capital* — The additional paid-in capital account of the target is carried forward and adjusted for any change in par value of the outstanding capital stock and is increased to reflect the effective issuance of shares to the SPAC shareholders in the transaction.
- *Retained earnings* — Retained earnings of the target are carried forward.

For periods before the reverse recapitalization, shareholders' equity of the combined company is presented based on the historical equity of the target restated using the exchange ratio to reflect the equity structure of the SPAC.

EPS is recast for periods before the acquisition date. The retroactive restatement is based on the same number of weighted average shares outstanding that the accounting acquirer presents as outstanding in each historical period under the guidance in ASC 805-40-45-1 through 45-2.

Shareholders' equity and EPS considerations outlined above are similar to that of a reverse acquisition pursuant to ASC 805. Refer to section 3.2.2.2.4 of our FRD, ***Business combinations***, for further discussion of reverse acquisition accounting and its effects on the equity accounts and EPS.

Reverse recapitalizations also result in a different treatment of transaction costs from that of a traditional forward merger. We understand that the SEC staff views these transactions as the issuance of equity by the accounting acquirer for the cash of the SPAC. Accordingly, direct and incremental transaction costs related to the de-SPAC transaction that wouldn't otherwise have been incurred are treated as a reduction of the SPAC's cash proceeds, and they are deducted from the combined company's additional paid-in capital rather than expensed as incurred. This treatment is similar to the treatment described in SEC Staff Accounting Bulletin Topic 5.A.

Emerging growth company eligibility

The assessment of whether the combined company continues to qualify as an EGC after the de-SPAC transaction depends on whether the transaction was accounted for as a forward or a reverse acquisition. The EGC eligibility of combined companies emerging from de-SPAC transactions is assessed using the historical revenues, age, debt and market value of the SPAC entity after a forward merger transaction. However, after a reverse acquisition transaction, certain metrics of the target entity are used in place of those of the SPAC.

The following table describes the EGC requirements for a combined company emerging from a de-SPAC transaction for both a forward merger and a reverse recapitalization.

Requirement	Forward merger	Reverse recapitalization
Annual gross revenue of less than $1.235 billion	Annual gross revenue of the SPAC entity during year of the de-SPAC transaction, including the gross revenue of the target entity for the period from the de-SPAC transaction to year end	Annual gross revenue of the operating company during the year of the de-SPAC transaction
Less than five years have elapsed since the IPO	SPAC IPO date	SPAC IPO date
Total issuances of debt securities of less than $1 billion during the immediately preceding rolling three-year period	Debt issuances of the SPAC entity, including the debt issuances of the target entity for the period from the de-SPAC transaction to year end	Debt issuances of the target entity for the three-year period, including the debt issuances of the SPAC entity for the period from the de-SPAC transaction to year end
Not a large accelerated filer[11] (public float of less than $700 million)	Public float of the SPAC, which is the legal issuer, on the last business day of its most recent second quarter	Public float of the SPAC, which is the legal issuer, on the last business day of its most recent second quarter

The SEC staff may allow management to skip reporting on internal controls in the first Form 10-K following a de-SPAC transaction.

If both the SPAC and the target company qualified as an EGC as of the effective date of the proxy statement or joint statement for the de-SPAC transaction, which included third-quarter financial statements for both entities, but the Super 8-K requires annual financial statements (i.e., third-quarter financial statements are stale) and the target company now fails to qualify as an EGC, the registrant would be required to, among other things, reflect the adoption of accounting standards applicable to public business entities and report CAMs. For that reason, the SEC staff encourages companies to consider including the disclosures that will be required in the Super 8-K in the proxy statement or joint statement, rather than waiting until the Super 8-K.

SRC status subsequent to the de-SPAC transaction

For purposes of the form and content of information in the Super 8-K, the SEC staff determines whether a non-reporting target is an SRC based upon its revenue (i.e., whether it has revenue of less than $100 million in its most recent fiscal year). Additionally, if the SPAC is an SRC at the time of the de-SPAC transaction, the combined company would retain the SRC status of the SPAC until its next redetermination date, which is after the de-SPAC transaction but before the first SEC filing (excluding the Super 8-K).

The redetermination, as required by the new rules, is based on public float measured within four business days after the de-SPAC transaction and annual revenues of the target company as of the most recently completed fiscal year included in the Super 8-K. However, non-SRC status is not required to be reflected in any filing (including an amendment to the Super 8-K) due in the 45-day period following the transaction.

There is no requirement to redetermine accelerated filer status, EGC status or FPI status after the de-SPAC transaction. See our **Technical Line, *Reminders on reporting and filer status considerations for SEC registrants***, for further discussion on assessing accelerated filer status, EGC status and FPI status.

How we see it

Companies that expect to file a new registration statement on Form S-1 after the 45-day grace period but before the next annual report is filed, will need to be prepared to provide more disclosures and/or financial statement periods as compared to those presented in the de-SPAC filing.

Change in fiscal year end

If the SPAC and the target company do not have the same fiscal year end, the combined company typically adopts the fiscal year of the target company when the de-SPAC transaction is completed and announces that in the Super 8-K filing. No transition report filing with the SEC is necessary in such cases, and the reporting of the combined company continues using the fiscal year of the target company.

If the combined company intends to adopt the fiscal year of the SPAC rather than the target, or if it intends to adopt a new fiscal year, the registrant is generally required to file a transition report on Form 10-K or Form 10-Q. For further discussion of transition report filing requirements, refer to our SEC Financial Reporting Series publication, ***SEC annual reports — Form 10-K***.

Internal control considerations

The combined company must consider the requirements that apply to public companies related to internal control over financial reporting (ICFR) and disclosure controls and procedures (DCPs). While the target company is not required to report on its ICFR as part of

the proxy/Form S-4 filing, management and its auditors may be required to report on ICFR once it becomes an issuer (i.e., the period subsequent to the Super 8-K). The target should also consider risk factor disclosure for any known material weaknesses.

Following the de-SPAC transaction, officers of the combined company will be required to evaluate DCPs on a quarterly basis and sign **Section 302 certifications**. These certifications are required for each Form 10-Q and Form 10-K filing (i.e., there is no relief for a newly public company). In addition, if the SPAC has previously filed its first Form 10-K, management would ordinarily be required to perform an assessment of the combined company's ICFR under Item 308(a) of Regulation S-K[12] for annual reports on Form 10-K.

However, for the company's Form 10-K covering the fiscal year in which the de-SPAC transaction was consummated, **Question 215.02** of the C&DI on Regulation S-K states, the SEC staff would not object to management omitting its assessment of ICFR under Item 308(a) of Regulation S-K if it is not possible to conduct an assessment. Issuers that apply this guidance should disclose why management's assessment has not been included in the annual report, specifically addressing the effect of the transaction on management's ability to conduct an assessment and the scope of the assessment if one were to be conducted.

However, when a de-SPAC transaction occurs shortly after year end and the company is required to file an amended Form 8-K to update the financial statements of the target to year end, that filing is viewed as the equivalent of the company's first annual report on Form 10-K, and subsequent Form 10-K filings should not exclude management's report on ICFR. For example, if the de-SPAC transaction was consummated in January 2021, the Super 8-K would not include the annual financial statements for the year ended 31 December 2020. In that case, the company would file an amended Form 8-K to include the annual financial statements of the target. That amended Form 8-K would be viewed to be the equivalent of a Form 10-K, and the annual report for the year ended 31 December 2021 would require management's assessment of ICFR (and auditor attestation, if applicable).

An EGC is not required to comply with the requirement to provide the auditor's report on ICFR under Section 404(b) of the Sarbanes-Oxley Act for as long as it qualifies as an EGC. Non-EGCs that are non-accelerated filers are also exempt from compliance with Section 404(b). The table below summarizes the requirements for compliance with Section 404(b) by filer and EGC status, subject to the exclusion relief discussed above.

Filer status	EGC vs. non-EGC	Required to comply with Section 404(b)?
Non-accelerated filer	EGC or non-EGC	No
Accelerated filer	EGC	No
	Non-EGC	Yes
Large accelerated filer	N/A	Yes

See our **Technical Line, *Reminders on reporting and filer status considerations for SEC registrants***, and our SEC Financial Reporting Series publication, ***SEC annual reports — Form 10-K***, for discussion of the requirements of each filer status.

Endnotes:

[1] If the target is an SEC accelerated or large accelerated filer, the target's balance sheet must be as of a date no more than 129 days before the date of the filing, except for third-quarter financial data, which must meet the requirements that apply to all other filers.

[2] If the transaction is structured so that a newly formed entity survives the merger transaction as the legal acquirer, entities should consider whether the newly formed entity is substantive. A newly formed entity that has no significant precombination activities other than to issue shares to consummate the transaction would not be identified as the accounting acquirer. See section 3.2.2.4 of our FRD, ***Business combinations***, for further guidance on determining whether a newly formed entity is substantive.

[3] ASC 805, *Business Combinations*.

[4] ASC 718, *Compensation — Stock Compensation*.

[5] ASC 480, *Distinguishing Liabilities from Equity*.

[6] 2021 AICPA & CIMA Conference on Current SEC and PCAOB Developments – *Compendium of significant accounting and reporting issues*.

[7] ASC 815-40, *Derivatives and Hedging — Contracts in Entity's Own Equity*.

[8] ASC 815-40-15, *Derivatives and Hedging — Contracts in Entity's Own Equity — Scope and Scope Exceptions*.

[9] ASC 815-40-25, *Derivatives and Hedging — Contracts in Entity's Own Equity — Recognition*.

[10] The Division of Corporation Finance Financial Reporting Manual is available at **https://www.sec.gov/corpfin/cf-manual**.

[11] Entities not subject to the reporting requirements of Sections 13(a) or 15(d) of the Exchange Act for at least 12 months are not large accelerated filers, regardless of market value.

[12] Item 308(a) of Regulation S-K is the codification of Section 404(a) of the Sarbanes-Oxley Act.

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SCORE No. 06219-191US
(Updated 21 March 2024)

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