What you need to know

- Being acquired by a special purpose acquisition company (SPAC) offers an alternative to an IPO for private companies that want to enter the public markets.
- All companies that are considering being acquired by a SPAC need to be aware of the special accounting and financial reporting requirements. For private companies, that means providing information that is similar to what they would need to provide in an IPO, but on an accelerated timeline.
- All companies merging with SPACs need to provide financial statements that comply with Regulation S-X for the merger proxy statement. The financial statements of companies reporting under US GAAP must also meet the requirements for public business entities.
- SPAC mergers require significant coordination between buyers, sellers and management of the target company.

Overview

Being acquired by a SPAC offers private companies a way to go public without having to conduct 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 target that has not been identified at the time of the IPO.

SPACs have become more popular in recent years, due to volatility in the IPO market, greater acceptance among the small and midsize private companies that are usually SPAC targets, and increasing interest from financial sponsors and management teams with experience in
private equity. US-listed SPAC IPOs raised more than $14 billion in 2018, up from just over $10 billion in 2017 and four times as much as the $3.5 billion raised in 2016. In 2018, US-listed SPAC IPOs accounted for approximately 21% of total IPO capital raised, roughly the same as in 2017, but up from 14% from 2016.¹

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 Securities and Exchange Commission (SEC) to conduct its IPO.

The SEC usually declares a SPAC IPO registration statement effective more quickly than a traditional IPO registration statement because the SPAC registration statement is simpler than that of an operating company. A SPAC’s 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 they typically qualify as emerging growth companies (EGCs), SPACs 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 because it hasn’t yet begun its search for a potential target.

As a result, the SEC staff usually issues fewer comments on a SPAC’s IPO registration statement, and those comments are easier to resolve than those on IPOs of more complex entities.

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 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 equity sold in a SPAC IPO consists of units, each typically comprising 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 an operating 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 an operating company. Proceeds from the IPO are placed in a trust account for use in an acquisition.

The SPAC then identifies one or more operating company targets for acquisition. These operating companies are usually privately held companies that use the SPAC merger to become publicly traded companies. A SPAC generally has 18 to 24 months from the date of its IPO to acquire a target, depending on the provisions of its charter documents. If an acquisition is not consummated during that period, the SPAC dissolves, and the IPO proceeds that are held in trust are returned to investors. SPACs sometimes seek approval from their shareholders to amend their charter documents to extend the acquisition deadline.

When a SPAC proposes to acquire a specific target company, public shareholders have the right to redeem their shares for a pro rata portion of the proceeds held in the trust account (usually an amount equal to their original investment, plus nominal interest) if they do not wish to invest in the proposed target. The warrants received as part of each SPAC unit in the IPO remain outstanding even if a shareholder elects to redeem its shares.
A SPAC often needs additional capital to fund the purchase of a proposed target. It also typically has “backstop” arrangements to fund any shortfall in cash available to complete the transaction caused by shareholder redemptions. A SPAC can secure this additional funding in several ways, including:

- Private investment in public equity (PIPE) deals, usually based on forward purchase commitments (i.e., those agreed upon in advance) by affiliates of the sponsor or institutional investors to purchase common stock if additional funds are needed to complete the acquisition
- Preferred equity investments that affiliates of the sponsors or institutional investors make, usually based on forward purchase commitments if additional funds are needed to complete the acquisition
- The sale of additional common stock to public investors
- The issuance of debt in the form of registered or unregistered notes, term loans or revolving credit facilities

The sellers of the operating company may receive cash, equity in the SPAC (or other successor entity) or a combination of the two. In most cases, the sellers of the operating company will retain some ownership in the merged entity (or the larger combined company if the SPAC acquires more than one operating company).

After the SPAC merger, the combined entity is the publicly traded company, usually governed by a board of directors that includes the SPAC’s sponsors or their representatives in addition to directors chosen by the sellers. The sponsors may retain the management of the target to manage the combined entity, or the sponsors may actively participate in managing the combined entity.

**SPAC merger requirements**

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

- The business combination
- 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

The 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. In addition to the proposals for shareholder approval listed above and various nonfinancial disclosures, the proxy statement or joint statement contains the following items:

- 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
- Management’s discussion and analysis of the SPAC and target(s)
- Selected historical financial data of the SPAC and target(s), including pro forma financial data
- Comparative per share information, including pro forma per share data
Financial statements

Determining the predecessor

Entities involved in SPAC mergers 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 have no significant activities and will acquire one or more businesses in a SPAC merger, at least one of a SPAC’s targets must be designated as the predecessor of the combined company. Most SPAC transactions involve only one target, which makes determining the predecessor straightforward.

In transactions involving more than one target, 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 entities. Factors to consider include the relative size and fair value of the entities and the ongoing management structure and operations of the merged 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 entities 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 operating company 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.

For both the SPAC and target entities, audited financial statements should be provided for at least the two most recent 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. If the target would qualify as an EGC if it were conducting its own IPO and if the SPAC hasn’t yet filed an annual report on Form 10-K, the SEC staff will not object to the proxy statement or joint statement presenting two years of the target’s annual financial statements. If the SPAC has filed a Form 10-K, it would need to present three years of financial statements for the target company, unless the target meets the definition of a smaller reporting company.

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 data, which is timely through the 45th day after the most recent fiscal year end.2 These financial statement age requirements also apply to the mailing date of a definitive proxy statement and the date of effectiveness for a joint statement.

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 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)**

<table>
<thead>
<tr>
<th>SPAC</th>
<th>Audited</th>
<th>Unaudited</th>
<th>Target</th>
<th>Audited</th>
<th>Unaudited</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance sheet</td>
<td>As of 2 March 20X2</td>
<td>As of 30 September 20X2</td>
<td>As of 31 December 20X1 and 20X0</td>
<td>As of 30 September 20X2 (comparative to 31 December 20X1)</td>
<td></td>
</tr>
<tr>
<td>Statement of operations</td>
<td>For the period from 26 February 20X2 (inception) through 2 March 20X2</td>
<td>For the period from 26 February 20X2 (inception) through 30 September 20X2</td>
<td>For the years ended 31 December 20X1 and 20X0</td>
<td>For the nine months ended 30 September 20X2 and 20X1</td>
<td></td>
</tr>
<tr>
<td>Statement of changes in shareholders’ equity and statement of cash flows</td>
<td>For the period from 26 February 20X2 (inception) through 2 March 20X2</td>
<td>For the period from 26 February 20X2 (inception) through 30 September 20X2</td>
<td>For the years ended 31 December 20X1 and 20X0</td>
<td>For the nine months ended 30 September 20X2 and 20X1</td>
<td></td>
</tr>
</tbody>
</table>

The proxy statement was filed on 11 February 20X3, before the 15 February 20X3 staleness date for third-quarter financial information. Because it was filed before the SPAC’s first annual report on Form 10-K and the target would qualify as an EGC if it were conducting its own IPO, the SPAC can present two years of the target’s audited financial statements.

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

<table>
<thead>
<tr>
<th>SPAC</th>
<th>Audited</th>
<th>Unaudited</th>
<th>Target</th>
<th>Audited</th>
<th>Unaudited</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance sheet</td>
<td>As of 31 December 20X2</td>
<td>N/A</td>
<td>As of 31 December 20X2 and 20X1</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Statement of operations</td>
<td>For the period from 26 February 20X2 (inception) through 31 December 20X2</td>
<td>N/A</td>
<td>For the years ended 31 December 20X2, 20X1 and 20X0</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>Statement of changes in shareholders’ equity and statement of cash flows</td>
<td>For the period from 26 February 20X2 (inception) through 31 December 20X2</td>
<td>N/A</td>
<td>For the years ended 31 December 20X2, 20X1 and 20X0</td>
<td>N/A</td>
<td></td>
</tr>
</tbody>
</table>

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. Additionally, because the SPAC has already filed its first annual report on Form 10-K and unless the target qualifies as a smaller reporting company, three years of the target’s financial statements are required.
Any proxy 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.

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 for use in the proxy statement or joint statement. Target entities that have elected private company accounting alternatives (e.g., amortization of goodwill) are required to unwind this accounting and revise their financial statements before including them in a proxy statement or joint statement.

A target that is considered the predecessor is also required to provide public company accounting disclosures, such as segment reporting, in its financial statements. For further discussion of public company disclosures to be considered in an initial filing with the SEC, refer to our Technical Line, *IPO financial statement accounting and disclosure considerations*.

Privately-held SPAC merger target companies should consider whether they are required to present earnings per share (EPS) disclosures in their financial statements or elsewhere in the proxy statement or joint statement. Accounting Standards Codification (ASC) 260, *Earnings Per Share*, applies only to entities whose common stock or potential common stock trades in a public market either on a stock exchange or in the over-the-counter market, or is being registered with the SEC. Target entities should work with their external advisers and auditors to determine whether they are within the scope of ASC 260.

**How we see it**

The SEC staff has not provided any special transition provisions for unwinding private company accounting alternatives, so 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.

**Audit and review considerations**

The financial statements of a target that has been determined to be the predecessor 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 independent in accordance with Article 2 of Regulation S-X for all periods. However, the financial statements of a target that is not the predecessor may be audited in accordance with the standards of the American Institute of Certified Public Accountants (AICPA).

**How we see it**

Companies contemplating a SPAC merger should evaluate 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 conducted the previous audit in accordance with AICPA standards is determined not to have been independent in accordance with SEC regulations for all periods, a change in auditor and a re-audit of the financial statements may be required.
Carve-out financial statements
If the target constitutes 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 acquired 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, but it may do so upon preclearance for a significant acquisition under Rule 3-05 of Regulation S-X.

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.

Cross-border considerations
If a foreign target is determined to be the predecessor in a SPAC merger, the transaction is treated as the “backdoor” listing of the target through a reverse recapitalization with a US public shell. If that’s the case, the proxy statement or joint statement must include the financial statements of the target prepared using US GAAP because the entity does not qualify as a foreign private issuer.

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 International Accounting Standards Board (IASB) or a 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 Item 17 of Form 20-F.

How we see it
Target companies in SPAC mergers face the same challenges as a company that conducts 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, SPAC mergers require significant coordination between buyers, sellers and target management, and the buyers and sellers often push to accelerate the transaction timeline relative to traditional IPOs.

Pro forma financial information
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. In addition to the discussion below, please 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.
Determining the accounting acquirer

For accounting purposes, the acquirer is the entity that has obtained control of another entity (i.e., the acquiree) and, thus, consummated a business combination. 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.

The determination of whether control has been obtained begins with the evaluation of whether control should be evaluated based on the variable interest or voting interest model. If the acquiree is a variable interest entity, the primary beneficiary would be the accounting acquirer. While SPACs are required to first consider whether the acquiree is a variable interest entity, the acquiree in a SPAC merger is typically a voting interest entity.

Under the voting interest model, determining which party holds the controlling financial interest in the combined entity and is therefore the accounting acquirer 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 indicate 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 entity is usually the acquirer. Because SPAC mergers 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 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 entity – Assuming none of the other factors indicate 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 operating company (target) received 30% of the outstanding shares of the combined company and no other shareholders 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 operating company would favor the operating company as the accounting acquirer.

- Composition of the governing body – Assuming none of the other factors indicate 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 entity for a sufficient period of time.

The SEC staff frequently comments on the determination of the accounting acquirer when it reviews pro forma financial information.
Composition of management – Assuming none of the other factors indicate which entity is the acquirer, the entity whose executive team manages or dominates the management of the combined entity generally is the accounting acquirer. While management of the combined company comes from the target in most SPAC transactions, new management may be appointed, or there could be a combination of new and continuing management. In these cases, the relative number of executive positions taken by the target’s and SPAC’s former management teams, and the roles, responsibilities and seniority of those positions, should all be considered.

Relative size of the combining entities – Assuming none of the other factors indicate which entity is the acquirer, if one of the combining entities is significantly larger than the other, that entity is generally the acquirer. Because the SPAC is a shell company with 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 indicate 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 if the combining entities are not public entities and the fair value of their shares being exchanged is difficult to objectively determine. Because the target is usually a private company, the reliability of the fair value measurement of the target’s shares should be considered in determining whether a premium has been paid in the exchange.

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.

How we see it
Determining the accounting acquirer in a SPAC merger 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 fair value of the operating company and its assets acquired and liabilities assumed are recognized in accordance with the guidance in ASC 805 (i.e., as a forward merger). The pro forma financial information included in the proxy statement or joint statement will reflect purchase accounting and will require a preliminary valuation of the operating company’s assets and liabilities.

If an operating company is determined to be the accounting acquirer, the accounting for the transaction 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 (i.e., a reverse recapitalization). Refer to section 3.2.2.2.5 of our FRD Business combinations for further discussion.
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 needs to illustrate 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 disclosures to the pro forma financial information.

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 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 SPAC mergers 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 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. Common matters include:

- **Carve-out adjustments** – In cases where a registrant acquires or succeeds to substantially all (but not 100%) 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.

- **Classification, valuation and accounting treatment of preferred equity instruments** – Preferred equity instruments issued in a SPAC merger may be complex and may contain features that are customized to meet investors’ requirements. Companies should consider engaging a third-party valuation specialist. Refer to our FRD **Issuer’s accounting for debt and equity financings** for a discussion of the factors to consider.
• **Earnings per share** – The capital structure of the combined company is based on that of the SPAC, adjusted for equity issuances and reclassifications resulting from the merger, regardless of whether the transaction is a forward or reverse recapitalization. The number of outstanding shares used to calculate pro forma EPS should reflect warrants that are “in the money,” as well as the EPS effects of any preferred equity instruments issued in the transaction. Refer to our FRD *Earnings per share*.

• **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 merger 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.

**Other proxy statement or joint statement items**

In addition to the financial statements and pro forma financial information, the proxy statement or joint statement is required to include management’s discussion and analysis of financial condition and results of operations, with selected historical financial data for both the SPAC and the target(s), as well as selected unaudited pro forma information and comparative per share information.

The proxy statement or joint statement will also include disclosures, among others, related to risk factors, quantitative and qualitative disclosures about market risk, properties, 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 the these disclosures, refer to our SEC Financial Reporting Series publications *2018 SEC annual reports — Form 10-K* and *2019 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 filed shortly after the SPAC merger (see further discussion below), which includes financial information of the target(s) similar to what would be provided if the target were to file its own registration statement. 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**

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 SPAC merger 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 section 5 of our SEC Financial Reporting Series publication *2018 SEC annual reports — Form 10-K* and section 3.7 of our SEC Financial Reporting Series publication *2019 SEC quarterly reports — Form 10-Q*. 
Selected historical and pro forma financial data

Selected historical financial data of the SPAC and the target(s) should be provided in accordance with Item 301 of Regulation S-K. In addition to annual periods presented, companies often voluntarily include interim disclosures for the periods presented in any interim financial statements included in the proxy statement or joint statement.

Item 301 of Regulation S-K requires that five years of financial data be presented for any target entity, even if the target would qualify as an EGC if it were conducting its own IPO. Companies that believe complying with this requirement is burdensome and would result in the disclosure of information that goes beyond what is material to investors may consider approaching the SEC staff to discuss potential relief.

For further discussion of selected historical financial information requirements, refer to section 4.3 of our SEC Financial Reporting Series publication **2018 SEC annual reports — Form 10-K**.

Selected pro forma financial data should be presented in the same form as the selected historical financial information for the periods and dates for which the unaudited pro forma financial information has been prepared (typically statement of operations data for the most recent fiscal year and interim period, and balance sheet data as of the most recent interim date). This data can be sourced directly from the unaudited pro forma financial information.

Comparative per share information

Comparative per share information should be provided for the same periods and dates for which the unaudited pro forma financial information has been prepared. The following information should be included for the SPAC and the target(s), as well as for the combined company on a pro forma basis:

- Book value per share
- Cash dividends declared per share
- Basic and diluted income (loss) per share from continuing operations

Comparative pro forma per-share amounts should be calculated by multiplying pro forma book value per share, pro forma net income (loss) per share from continuing operations and pro forma cash dividends per share by the exchange ratio (i.e., the number of SPAC shares exchanged for each target entity share) so that the comparative pro forma per-share amounts reflect the values for one target company share.

Basic and diluted weighted average shares outstanding are also usually presented as part of the disclosure.

**Illustration 3 — Comparative pro forma book value per-share calculation**

ABC SPAC intends to acquire XYZ Inc. and will issue one share of ABC SPAC common stock, with a fair value of $10 per share, for two outstanding XYZ Inc. common shares (exchange ratio of 50%). XYZ Inc. has been determined to be the accounting acquirer and the transaction will be accounted for as a reverse recapitalization.

ABC SPAC has $7,500 in cash proceeds from the sale of 750 units in its IPO that are subject to redemption, and the cash is held in a trust account. Any proceeds not needed for redemptions will become available at the time of the SPAC merger. The proceeds will be used to repay assumed debt of XYZ Inc., and any redemptions will be backstopped by new debt.
The historical and pro forma balance sheets of ABC SPAC and XYZ Inc. are as follows:

<table>
<thead>
<tr>
<th>Combined pro forma</th>
<th>ABC SPAC</th>
<th>XYZ Inc.</th>
<th>Assuming minimum redemptions</th>
<th>Assuming maximum redemptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mezzanine equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ordinary shares subject to possible redemption</td>
<td>7,500</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Shareholders' equity</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $1 par value</td>
<td>500</td>
<td>5,000</td>
<td>3,750</td>
<td>3,000</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>100</td>
<td>500</td>
<td>9,300</td>
<td>2,550</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>(50)</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Total shareholders’ equity</td>
<td>550</td>
<td>6,000</td>
<td>13,550</td>
<td>6,050</td>
</tr>
<tr>
<td>Common shares outstanding</td>
<td>500</td>
<td>5,000</td>
<td>3,750</td>
<td>3,000</td>
</tr>
</tbody>
</table>

The net book value per share disclosures would be as follows:

<table>
<thead>
<tr>
<th></th>
<th>Historical</th>
<th>Pro forma (assuming minimum redemptions)</th>
<th>Pro forma (assuming maximum redemptions)</th>
<th>Equivalent pro forma (assuming minimum redemptions)</th>
<th>Equivalent pro forma (assuming maximum redemptions)</th>
</tr>
</thead>
</table>

Calculation notes:

[1] Total shareholders’ equity divided by common shares outstanding. Note that if the financial statements of the target include noncontrolling interests, the SEC staff has said that net book value per-share calculations should reflect the shareholders’ equity excluding the noncontrolling interest.

[2] Pro forma total shareholders’ equity divided by pro forma common shares outstanding.

[3] Pro forma net book value per share multiplied by the exchange ratio (50%).

Filing review and comment process

Because SPAC mergers often result in a private operating company becoming a publicly traded entity, the SEC staff usually reviews 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. SPACs can expect to receive a few rounds of SEC staff comments before the definitive proxy can be filed and mailed or a joint statement can be declared effective and mailed. 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 addition to transaction-specific comments, SPACs often receive comments about the same topics as other companies. Refer to our 2018 trends in SEC comment letters and Trends in US IPO registration statements publications 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 SPAC mergers need to remember that the SPAC is required to mail the SPAC merger proxy statement to investors, usually 20 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 SPAC merger, 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 71-day due date extension for financial statements typically available for business combinations under Item 9.01 does not apply to SPAC mergers.

As discussed above, 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 disclosure requirements of Item 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. While many of the disclosures in the Super 8-K would be identical to those in the proxy statement or joint statement, financial statements and related disclosures may need to be updated due to age requirements. 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.

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 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 sections 6.1 and 6.2 of our SEC Financial Reporting Series publication 2019 proxy statements, an overview of the requirements and observations about current practice for a discussion of this requirement.

How we see it
Companies involved in SPAC mergers 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-SPAC merger considerations

Post-transaction Securities Act offerings

After a SPAC merger closes, the combined company may file a registration statement on Form S-3 to register both shares that will be issued when the warrants issued in the SPAC’s IPO are exercised and any other outstanding and unregistered shares.

Companies also commonly file a separate shelf registration statement on Form S-3 and related prospectus supplements to consummate follow-on equity offerings for general corporate purposes. Companies emerging from SPAC mergers usually qualify for use of Form S-3 12 months after their IPOs. However, they are specifically disallowed from qualifying as well-known seasoned issuers for three years following a change in shell company status (SPAC merger). 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 SPAC merger, no new financial information should be required. However, if the SPAC merger was accounted for as a reverse recapitalization and the registration statement is filed after the filing of such a periodic report, it could require recasting the prior annual financial statements of the target to reflect the recapitalization in the subsequent SPAC merger.

Post-transaction Exchange Act reporting

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

Updating target company financial statements on Form 8-K

If the SPAC merger closes after the target’s most recently completed reporting period but 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 have not been issued.

To update the target financial statements included in the Super 8-K filing so that there is no lapse in the filed financial statement periods of the predecessor target, the registrant must file an amended Form 8-K with the target’s financial statements for the most recently completed reporting period within 90 days of period end for annual periods and 45 days for interim periods.

Illustration 4 – Due date for updating target company financial statements

ABC SPAC 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 SPAC merger would be the quarterly report on Form 10-Q for the quarter ended 31 March 20X3.
Financial statement presentation and disclosures following a forward merger

After the SPAC merger, 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).[3]

The application of purchase accounting to the financial statements of the target in a forward merger results in a different 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 SPAC merger 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 disclosures should also include traditional business combination related items, including purchase price allocation and pro forma disclosures. 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 entity 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 enterprise is presented based on the historical equity of the target restated using the exchange ratio to reflect the equity structure of the SPAC.

EPS are recasted 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 SPAC merger 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 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 SPAC merger depends on whether the SPAC acquired the target in a forward or a reverse acquisition. The EGC eligibility of combined companies emerging from SPAC mergers 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 SPAC merger.

<table>
<thead>
<tr>
<th></th>
<th>Forward merger</th>
<th>Reverse recapitalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual gross revenue of less than $1.07 billion</td>
<td>Annual gross revenue of the SPAC entity during year of the SPAC merger, including the gross revenue of the target entity for the period from the SPAC merger to year end</td>
<td>Annual gross revenue of the operating company during the year of the SPAC merger</td>
</tr>
<tr>
<td>Less than five years have elapsed since the IPO</td>
<td>SPAC IPO date</td>
<td>SPAC IPO date</td>
</tr>
<tr>
<td>Total issuances of debt securities of less than $1 billion during the immediately preceding rolling three-year period</td>
<td>Debt issuances of the SPAC entity, including the debt issuances of the target entity for the period from the SPAC merger to year end</td>
<td>Debt issuances of the target entity for the three-year period, including the debt issuances of the SPAC entity for the period from the SPAC merger to year end</td>
</tr>
<tr>
<td>Not a large accelerated filer (public float of less than $700 million)</td>
<td>Market value of the SPAC, which is the legal issuer, at its most recent second quarter reporting date</td>
<td>Market value of the SPAC, which is the legal issuer, at its most recent second quarter reporting date</td>
</tr>
</tbody>
</table>

**Change in fiscal year end**

If the SPAC and the target entities do not have the same fiscal year end, the SPAC typically adopts the fiscal year of the target company when the merger is completed. 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 section 2.16 of our SEC Financial Reporting Series publication **2018 SEC annual reports – Form 10-K**.

**Internal control considerations**

Under SEC staff guidance, management may skip reporting on the internal controls of acquired businesses when it assesses internal control over financial reporting under Section 404(a) of the Sarbanes Oxley Act in the first Form 10-K following a material business combination. Management may use this exclusion, regardless of whether the combined entity is an EGC or its filer status. Management should apply judgment to determine whether it is possible to complete an effective assessment of the target’s controls considering the timing of the acquisition.
In SPAC mergers, the internal controls and processes of the target are generally the only ones remaining after the transaction. As a result, if management applies the internal control exclusion, there are no meaningful controls to assess as of year end. Depending on the timing of the transaction and other factors, the SEC staff may not object to management omitting a report on internal controls from the company’s Form 10-K entirely.

However, when a SPAC merger 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 internal control over financial reporting.

EGCs are not required to comply with the requirement to provide the auditor’s report on internal control over financial reporting 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.

<table>
<thead>
<tr>
<th>Filer status</th>
<th>EGC vs. non-EGC</th>
<th>Required to comply with Section 404(b)?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-accelerated filer</td>
<td>EGC or non-EGC</td>
<td>No</td>
</tr>
<tr>
<td>Accelerated filer</td>
<td>EGC</td>
<td>No</td>
</tr>
<tr>
<td>Large accelerated filer</td>
<td>N/A</td>
<td>Yes</td>
</tr>
</tbody>
</table>

See section 2.1 of our SEC Financial Reporting Series publication 2018 SEC annual reports – Form 10-K for discussion of the requirements of each filer status.

Endnotes:

1 For purposes of this publication, an IPO is defined as a company’s first registered offering of equity securities to the public. This publication discusses only IPOs for which the data provider Dealogic offers data on the issue date (the day the offer is priced), the trading date (the date on which the security first trades) and proceeds (funds raised, including any overallotment sold). The data we cite excludes companies with the following Standard Industrial Classification codes:
   • 6091: Financial companies that conduct trust, fiduciary and custody activities
   • 6371: Asset management companies such as health and welfare funds, pension funds and their third-party administration as well as other financial vehicles
   • 6722: Companies that are open-end investment funds
   • 6726: Companies that are other financial vehicles
   • 6732: Companies that are grant-making foundations
   • 6733: Asset management companies that deal with trusts, estates and agency accounts
   We have included only IPOs on the three major US exchanges: New York Stock Exchange (NYSE), NASDAQ and NYSE MKT.
2 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.
4 Entities not subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for at least 12 months are not large accelerated filers, regardless of market value.