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SPAC Transactions

Should Your Company be SPACkled?

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The latest and newest 'craze' to hit Wall Street are Special Purpose Acquisition Companies, or SPACs. While SPACs have been around for decades, their popularity has recently increased exponentially. *There have been 433 IPOs on the US stock market this year, as of April 21, 2021. That is +982.5% more than the same time in 2020, which had 40 IPOs by this date*¹. The majority of these IPOs have been SPACs.

What is a SPAC and Why do I care?

A SPAC is a public shell company that is formed with the sole intention of buying or acquiring a private company. Upon completion of the acquisition, the private company (otherwise known as the 'target' company) becomes a public company through the SPAC. For the privately owned company, this process can mitigate some of the inherent market uncertainties in the IPO process. A SPAC generally has little or no permanent staff, no operations and will rely extensively on the acquired company for its on-going operations, financial reporting, management, etc. after the acquisition.

While technically the private company is the company that has been acquired, through some SEC magic, the private company is the surviving company and it becomes the SEC registrant. Thus, a private company being acquired in a SPAC acquisition is a means for a private company to raise equity capital and become an SEC registrant, very similar to a private company going through the IPO process, albeit generally faster and with a few less hassles and market uncertainties.

There are hundreds of SPACs with billions of investment dollars searching for the right acquisition target. For a privately held company looking to raise capital or go public, a SPAC may be the ideal vehicle to accomplish its financial objectives. However, similar to a traditional IPO process there is a lot of preparation towards becoming SEC-ready to help attract the SPAC. I call this process 'SPACKling'².

How and Who Creates a SPAC?

A SPAC is formed by a Sponsor who raises cash through an IPO. SPAC Sponsors can be venture capitalists, private equity investment companies or experienced investors. The Sponsor forms the

¹ <https://stockanalysis.com/ipos/2021-list/>

² In a previous life, I sold spackle to painters to fill in holes in wallboard before painting. Painters referred to this process of applying spackle to fill in the holes as "spackling." Similar to painters, professionals, like KU assist in filling in the holes to get a company ready as a potential SPAC acquisition target. I refer to this SPAC readiness as 'SPACKling'.



SPAC and advances money to the SPAC to raise cash through an initial public offering, or IPO. Since a SPAC has a limited history and little operations, the S-1 and the IPO process is relatively simple. The cash raised in the IPO is generally held in trust until a suitable acquisition target has been identified. Upon completion of the IPO, a SPAC is under pressure to complete an acquisition, usually within 24 months, or the cash must be returned to the investors. Through the Sponsor, the SPAC will look at numerous potential targets and conduct exhaustive due diligence before a suitable target has been identified.

The De-SPACing Process

Once the SPAC has identified a suitable target, the SPAC and the target will execute a definitive merger agreement. The period after the execution of a definitive merger agreement is known as the 'de-SPACing' process. Typically, the SPAC is then required to obtain shareholder approval via a shareholder proxy vote and SPAC shareholders that are not in favor of the merger may request a return of their investment. The proxy vote may take three to five months to complete. There is always a risk that some number of SPAC investors may withdraw from the SPAC and have their funds returned. For this reason and for addition leverage, a SPAC merger transaction typically includes debt and/or additional commitments of equity financing through private investments in public equity (PIPE).

To affect the shareholder proxy vote, the de-SPACing process generally requires the SPAC to prepare a proxy statement which is filed with the SEC that meets the SEC requirements for a tender offer³. This requires the proxy to include audited financial statements of the Target company and certain interim financial information, including pro-forma financial data on the merged company. As a result, the proxy statement requires extensive involvement by the Target company. Typically, in a SPAC transaction, the SEC will review the proxy statement and provide comments that are required to be addressed prior to the proxy vote.

Once the proxy vote and the merger are completed, the SPAC is required to file a special form 8-K, or a 'Super 8-K' within four business days of completion of the merger. The Super 8-K must contain audited financial statements, interim financial information and extensive disclosures about the Target company. The Super 8-K includes all the information that would have been required if the Target were filing an initial registration statement. Therefore, the SPAC and the Target should ensure that the acquisition is not closed until all the financial information required for the Super 8-K, including financial statements that comply with the SEC's age requirements, is available and audited in accordance with the standards of the PCAOB.

What Types of Private Companies are Targets of a SPAC?

Generally, any company that is looking to raise equity capital or go public through an IPO should consider the SPAC alternative. Oftentimes business owners underestimate the commitment of resources needed to conduct a successful IPO and to operate as a public company thereafter. Being acquired by a SPAC can be faster and less burdensome than the IPO route. A SPAC already has the structure ready to operate as a public company offering a shell for the acquired company to merge into and, in most cases, a faster method to go-public compared to a traditional IPO. However, a SPAC merger is complex and involves significant costs, management effort and can be very challenging.

³ A joint registration and proxy statement on Form S-4 is required if the SPAC intends to register new securities as part of the merger.



How Can my Company become an Attractive Target for a SPAC?

An ideal target for a SPAC depends on the formation documents of the SPAC itself. Some SPACs are formed to target specific industries, others may target growth companies while others may target pre-revenue start up enterprises. A well thought out and concise business plan, a seasoned management team well versed in the company's operations and a company that is ready to be a public company are all coveted qualities in a SPAC acquisition target.

The readiness of the Target can greatly expedite the process from start to finish. Since the SPAC process is generally shorter than the IPO process, the SPAC/IPO readiness of the Target is critical to the timely completion of a SPAC merger. We refer to the process of getting your company ready for being acquired by a SPAC as getting 'SPACKled'.

What is Involved in SPACKling a Company?

SPACKling is basically the process of completely revamping your company from operating as a private company to operating as a public company. This involves a multidisciplinary and cross functional, sometimes evolutionary, change in the structure and operations of a company. Some of these changes should be implemented before, some during and some can be implemented after the completion of the transaction. Considerations include:

1. Accounting and financial reporting:
 - a. Is your staff well versed on the requirements of SEC reporting (10-K, 10-Q, 8-K)?
 - b. Does your staff have the proper tools and financial reporting software to meet the rigorous demands of public company reporting?
 - c. As a public company, you may no longer place any reliance on your external auditor for technical accounting guidance. Does your staff have the capabilities to address technical accounting issues?
 - d. Have your historical financial statements⁴ been prepared in accordance with US GAAP and SEC requirements for public companies?
 - e. Do you have up to three years of audited financial statement that have been audited in accordance with PCAOB requirements?
2. Corporate governance:
 - a. Do you have the right mix of Board of Director members and documented charters for the needed standing committees of your Board of Directors?
 - b. Do you have a functioning audit committee?
 - c. Do you have a management team that sets a proper tone at the top with respect to ethics, internal controls and regulatory compliance?
 - d. Do you have a whistle blower complaint system?
3. Internal controls and internal audit:
 - a. Do you have an appropriate system of internal controls designed and operating at a high level?
 - b. Do you have the resources to comply with Sarbanes-Oxley (disclosure controls and internal control over financial reporting)?
 - c. Do you understand what it takes to ensure that the 5 components and 17 principles are 'present' and 'functioning' per COSO's *Internal Control – Integrated Framework*?
 - d. If you have international operations, do you have FCPA compliance personnel?
 - e. If you are looking to list on the NYSE, do you have an internal audit function (can be internal, outsourced or co-sourced)?

⁴ Up to three years of audited financial statements may be required for the proxy statement/S-4 and Super 8-K.



4. Tax structuring:
 - a. Is your company optimally structured for a SPAC acquisition?
 - b. Are there tax structures that should be considered that might preserve tax NOLs?
5. Legal:
 - a. Is your legal staff well versed in SEC compliance matters or can you outsource such requirements?
 - b. Is your legal staff capable of handling ethics or whistle blower complaints?
6. Human Resources:
 - a. Do you have an appropriate ethics policy and company personnel manual?
 - b. Does your HR group demonstrate a commitment to attract, develop and retain competent individuals (i.e., principle 4 of the COSO Framework)?
7. Investor Relations:
 - a. Will you outsource or hire personnel to handle investor relations?
 - b. Are they properly trained with the SEC's fair disclosure regulations?

That Sounds Intimidating. Where can I get Assistance in SPACking my Company?

Glad you asked that question. At Kral Ussery, we offer scalable solutions that will assist you in SPACking your company. We have extensive expertise in SOX and internal controls, technical accounting, SEC reporting, systems evaluations and implementations, business process re-engineering, and much more. We can assess your readiness and develop scalable solutions that provide the right mix of assistance and training to Spackle your company.

We can start with a SPAC readiness assessment where we take a hard look at your company's current state and develop a plan for getting your company ready for the SPAC merger process and to prepare your company to meet the extensive requirements of being a public company. Our plans typically involve a combination of using our resources and leveraging your existing staff to achieve a cost-effective approach. We assist you in developing a comprehensive plan and timeline of areas that should be addressed;

- before the signing the definitive agreement to make your company a more attractive SPAC target,
- during the de-SPACing process and
- after the completion of the merger.

Prior to the de-SPACing process, our assistance might include:

1. Identifying differences in financial reporting between historical private company financial statements and public company requirements and, if necessary, developing and drafting historical financial statements and footnotes to comply with US GAAP and SEC reporting requirements.
2. Identifying any changes that may be required in corporate governance, accounting and financial reporting, and other areas.

During the de-SPACing process, we typically assist target companies in:

1. Drafting the proxy, registration statement and super 8-K
2. Assistance in drafting the management's discussion and analysis
3. Establishing a work program for SOX compliance
4. Assistance in responding to SEC comments
5. Assistance with auditor interaction



Subsequent to the de-SPACing process, our assistance might include:

1. Assistance in drafting the 10-K, 10-Qs and etc.
2. Assistance in setting up monitoring systems for SOX compliance
3. Assistance in setting up required disclosure controls and procedures
4. Staff augmentation until internal staff can be hired and trained
5. Internal audit outsourcing
6. Assistance with complex accounting issues

Conclusion

If you or your company is ready to be SPACkled or is contemplating a SPAC transaction, we are here to help.

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Kral Ussery LLC serves US public and private companies to protect and grow shareholder value, as well as non-profits and governments with internal controls and in combating fraud. We assist entities with governance and in all matters relating to financial reporting, including SEC compliance, internal controls testing and remediation, IT general controls, IPO/SPAC readiness, M&A transactions and US GAAP. Visit us at www.KralUssery.com.

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