Be Mindful that Becoming Public Company is Just the Start of the Journey

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There has been a recent spike in private companies going public. Much of that activity has to do with a growth in special purpose acquisition companies (SPACs). In a nutshell, a SPAC is a shell company that is formed and registered with the SEC as a public company with the intent to find and merge with a promising private company. The SPAC is funded by investors who make cash contributions to acquire shares in the SPAC. The SPAC manager then searches for an appropriate target company to acquire. Upon execution of the merger, the SPAC exchanges cash with the target company to generally acquire all of the target company's common stock, resulting in the target company merging with the SPAC and instantly becoming a public company registered with the SEC.

There is a lot of preparation that a private company must perform prior to merging with the SPAC because once the merger closes, the private company becomes the legal successor to the SPAC's reporting obligations. For example, once the SPAC merger occurs, the new combined public company must file a super 8-K with the SEC within four business days. The super 8-K must contain all of the information required in a Form 10. In other words, the private company, which generally comprises all of the activity of the new combined company (as the SPAC is just a shell prior to the merger), must be prepared to file essentially all of the financial and other information that would be required in a Form 10-K registration statement.

Many private companies do not have sufficient accounting and finance resources to prepare all of the information that will be required to be filed with the SEC as part of the SPAC merger. Furthermore, these private companies often set ambitious deadlines to complete the SPAC merger in order to take advantage of favorable market conditions. They often hire consultants and contractors to help them prepare the requisite financial information. The focus on this task becomes a top priority and can become consuming.

However, what many private companies often neglect is that the journey of becoming a public company does not end with the initial filing requirements of the SPAC merger. Once a registrant, the company must comply with the continuous reporting requirements under the Exchange Act. For example, the company must file a Form 10-Q generally within 45 days after the end of each quarter and a Form 10-K generally within 90 days after the end of each fiscal year (as a non-accelerated filer). Public companies are also required to provide a report on the effectiveness of its internal controls over financial reporting (ICOFR) after their first year as a public filer.[1] Depending on the company's filing status, that report may need to be accompanied by a similar report issued by its independent auditors.

Many private companies that become public in a relatively short period of time will not have the requisite policies and procedures in place to ensure an effective system of internal controls over financial reporting. Furthermore, they usually will lack the sufficient accounting and finance resources with the requisite skills to determine the accounting for complex transactions, monitor the development of and implement new accounting standards and SEC reporting requirements, and effectively execute ICOFR. The result is that the management and auditor reports on ICOFR often will identify one or more material weaknesses. Having to report material weaknesses in ICOFR will convey a notion that the financial information provided by the company is at risk of not being reliable, accurate, and complete. In turn, this can result in a discounted stock price, higher funding costs, and more scrutiny from the SEC and other regulators as well stock analysts and investors.

[1] Starting with the second annual report filed in the Form 10-K after the merger.

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Recently, the SEC has issued public statements on certain financial reporting considerations and select issues related to SPACs.[2] In those statements, the SEC staff reminds SPAC registrants of the need to comply with the various SEC filing requirements and to maintain an effective ICOFR. The SEC staff also mentions some of the accounting requirements and complex accounting issues that must be addressed in a SPAC merger (e.g., applying GAAP for public companies, determining the accounting acquirer, and accounting for earnout arrangements).

In the rush to go public, especially through an accelerated process like a SPAC merger, private companies should not lose sight of the accounting and financial reporting infrastructure that the company needs to have in place after becoming a public company. The completion of a SPAC merger is not the end but just the beginning of the journey. Private companies would be wise to get a head start on getting prepared to have the necessary and appropriate accounting resources, policies, and procedures in place to meet the ongoing filing requirements and maintain an effective system of ICOFR. This will allow them to minimize and quickly remediate any material weaknesses that are identified in the first year of being a public company.

In assisting many private companies prepare for the Day 1 public company filing requirements, we have observed on more than one occasion that not much attention was given to what would be needed for Day 2. As the saying goes, be careful what you wish for.

[2] SEC, Division of Corporation Finance, *Staff Statement on Select Issues Pertaining to Special Purpose Acquisition Companies* (March 31, 2021) and SEC, Office of the Chief Accountant, *Financial Reporting and Auditing Considerations of Companies Merging with SPACs*, a public statement (March 31, 2021)

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