Chapter 1

SPAC: Considerations for assessing public company readiness

This article aims to:
Discuss key considerations for assessing public company readiness following SPAC route beyond the closing of the transaction and life beyond as a public company.

Introduction

In our previous editions, we discussed how merger of companies following Special Purpose Acquisition Companies (SPAC) route is increasingly becoming popular and how they are different from a traditional IPO. Also, we discussed, what could be the key accounting and financial reporting considerations in a de-SPAC transaction.

Though SPAC may offer potential advantages, it is also equally important to assess the readiness to be operating as a public company given the compressed time frame the route offers for completion of the entire transaction. The challenges could range from ensuring timely filings and other regulatory compliances, instituting necessary processes and technology, skilled resources, and adequate and timely reporting to shareholders. These considerations may also hold good after the completion of the transaction. In this article, we will cast our lens on some of the key points which could help in assessment of public company readiness.

Reporting considerations

- **Financial reporting:** A newly listed public company would need to ensure that it has adequate accounting policies, and other related procedures are in place as well as related audit readiness which can address complex accounting transactions and financial statements including those that could arise due to merger and consequent listing. Accounting changes, errors, or misstatements in the previously issued financial statements could have a great impact on the investors and thereby could affect the share prices of the company as well.

  To address financial reporting complexities, a public company would also need to ensure that robust internal controls are in place along with proper risk assessment process. Timely communication with auditors can ease the evaluation and implementation of the controls around financial reporting.

  Some of the other areas to consider are:

  a. Assess accounting systems and related systems to ensure compliance with regulatory reporting timelines

  b. Determine key metrics and non-GAAP measures to be reported to investors

  c. Evaluate if there is a need for an internal audit function (in-house or outsourced)

  d. Potential tax implications to be communicated to stakeholders.

- **Budgeting and forecasting:** Another critical area to consider is including forward looking statements in the company's communications to the shareholders that can promote investor confidence. For this, a public company would need to ensure that it has proper and rigorous budgeting and forecasting processes.

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Management Discussion and Analysis (MD&A)

The MD&A section in the annual report provides users of the financial statements with integrated information providing a context for the related financial statements which will allow investors to view the entity from the same perspective as its management. The U.S. SEC[1] frames rules for the information to be provided in the MD&A section of a public traded company to ensure whether the company has presented all noteworthy information about the company's liquidity status, capital of the company, and its operations. A public company formed through a SPAC route would need to gear up to provide management's view of the entity's performance, position and progress (including forward looking information). The MD&A should be able to supplement and complement information presented in the financial statements. Therefore, it will be imperative for the management of the public company formed through a SPAC route to also ensure that it has provided adequate information. These disclosures should reflect the facts and circumstances specific to each individual company, including cost implications, results of their operations, liquidity and capital resources, material information relevant to an assessment of the financial condition and results of operations and potential capital expenditures which it may incur subsequent to the transition.

Additionally, MD&A should elaborate on the material risk factors that could affect a public company and its securities.

Auditor consideration

Private companies transitioning to public through SPAC may also need to consider whether there is a need to appoint a new auditor who is registered with the PCAOB[2] and has the experience of reporting on SEC registrants including in the context of SPAC transactions. Target companies who are able to avoid switching auditors will often need to revise, or retrofit, their historical financial statements to be included in the proxy statement to conform with public company reporting requirements. The retrofitting process involves much more in-depth auditing than what is normally required for a private company. The retrofitted financial statements must reflect up-to-date public company accounting standards and all accounting policies must be scrubbed to eliminate practical expedients that are only available to private companies. Auditor independence considerations would also be necessary for the success of the entire SPAC process.

Governance

Similar to an IPO, going public through SPAC will involve rigorous regulatory and market scrutiny. It will involve intense discussions with the investors and other market participants including analysts. As various parties are involved in a SPAC transaction which could have access to material information, there could also be heightened risk of insider trading. Therefore, there would be a need for an effective board governance while entering into a SPAC transaction. The SPAC board should be composed of directors with deep expertise and leaders who have experience of operating a public company. It should have requisite committees, including an audit committee, comprising of directors with an objective outlook and ability to deal with the multi-stakeholder interests in a public company. The board of directors (of the acquirer who may continue in the combined company) should keep close tabs on the due diligence of the target company. They may need to think about how to mitigate any potential downside risks, in particular, those related to Environmental, Social, and Governance (ESG) risks.

A well-designed process in place as part of the execution of the SPAC transaction can help manage many risks. This would include development of adequate policies and procedures for SPACs (e.g. insider trading, conflict of interests, etc.), and also ensuring that sufficient internal controls are in place to timely red-flag the potential risks that could arise out of such transactions and can pose serious implications to the functioning of the organisation.

Control and risk management

A public company formed through a SPAC route should aim to implement a strong and effective risk management and control system to promote stability throughout the entire financial reporting system. The controls should be designed to ensure that transactions are properly recorded and verified including appropriate segregation of duties. Companies may also need to strengthen their internal controls over financial reporting which will be subject to auditors' testing and will also be communicated to the audit committee. This would also warrant maintenance of adequate and sufficient control documentation evidencing the operational effectiveness of processes and controls.

In addition to the auditor attestation on controls framework, the Sarbanes-Oxley Act (SOX) imposes significant quarterly and annual CEO[3] and CFO[4] certification requirement. The CEO and CFO of a publicly traded company are required to issue a statement certifying that accompanying financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the company. Another compliance area is that all annual financial reports must include an internal control report stating that management is responsible for an adequate internal control structure along with an assessment by management of the effectiveness of the control structure. Further, SOX imposes criminal penalties for certifying a misleading or fraudulent financial report. Therefore, a well-established and well recognised control framework would act as a building block for the implementation of the requirements of the SOX.

1. The U.S. Securities and Exchange Commission
2. Public Company Accounting Oversight Board
3. Chief Executive Officer
4. Chief Financial Officer

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The risk management system must fit and protect the public company against market risk, credit risk, legal risk, operational risk and liquidity risk.

Another important area to focus on is the cybersecurity risk. The SEC provides guidance to public companies about cybersecurity disclosure obligations. A public company would need to develop substantive cybersecurity risk management policies and procedures. Additionally, a public company would need to disclose the board's role in overseeing cybersecurity risks.

Employee communication

Having the right talent in the organisation is essential for a successful transition and subsequent life as a public company. In this context, an engaged workforce is a prerequisite and has a positive impact during and after the SPAC transaction. Therefore, training in international standards and compliances, enhancing the role requirements and timely communications should be a priority of the company's executive board when planning to go public. Clear communication about the transaction to the workforce can help address the anxiety and inspire employees to ensure business continuity and boost productivity, reinforce the culture, and preserve customer and vendor relationships. Focus should also be on regular and periodic training of the employees on the requirements they may need to comply with once listed for instance, insider trading norms, material non-public information, and public company reporting requirements.

The transition to public company may also require companies to relook at their employee compensation model including introduction or amendments to their existing share-based payment arrangements.

Technology

Adequate systems to support both internal management reporting as well as external reporting whether for regulatory or investor communication purposes including operational metrics, non-GAAP measures, other non-financial information, and data analytics are key to the entire SPAC process. Companies intending to go public should invest in relevant technology platforms during the transaction phase itself. Additionally, consider adequacy of skilled resources or the need to build new capacity which can facilitate the transition, meeting reporting timelines and other challenges that could arise on becoming a public company.

Sponsor/SPAC considerations

While ensuring compliance with timelines is crucial in a SPAC transaction, its success also depends on the sponsor and target company's relationship as both are required to exercise due diligence. Some of the key considerations could include:

a. Assessment of sponsor's/SPAC industry knowledge

b. SPAC/sponsor's experience in capital markets

c. Understanding of the terms of agreement including business objectives.

Investor relations

Continuous engagement with the investors will be critical for the newly listed public company. Such a company would be required to develop a comprehensive investor relations strategy which would aid in developing liquidity and visibility for the company's stock. Investor relations of a company are expected to provide accurate and complete information to all investors on a timely basis. These communications include earning conference calls/webcasts, one to one discussion with investors, sustainability reporting, etc. The strategy for an effective investor relations would require investor relations department to be familiar with the company's strategic direction, budgets, forecasts, etc.

Other considerations

The U.S. Foreign Corrupt Practices Act (FCPA) also requires publicly traded companies to maintain accurate books and records and to have a system of internal controls sufficient to provide reasonable assurances that transactions are executed and assets are accounted for in accordance with management's authorisation and recorded as necessary to permit the preparation of financial statements in conformity with the Generally Accepted Accounting Principles (GAAP). Companies undertaking SPAC transactions would need to ensure continued compliance with the FCPA requirements. Also, they may need to device adequate mechanisms to ensure that the employees and their officers do not resort to prohibited trade practices, including bribing foreign officials to be in business.

Conclusion

As soon as the SPAC route becomes a likelihood, companies should conduct an extensive analysis of their people, processes, and technology. The aim should be to think beyond completing the SPAC merger. A comprehensive plan coupled with skilled workforce, robust processes and systems will enable a target to achieve its desired objective of becoming public through SPAC route. Nonetheless, compliance with financial and other regulatory reporting requirements is key to effective transition.

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