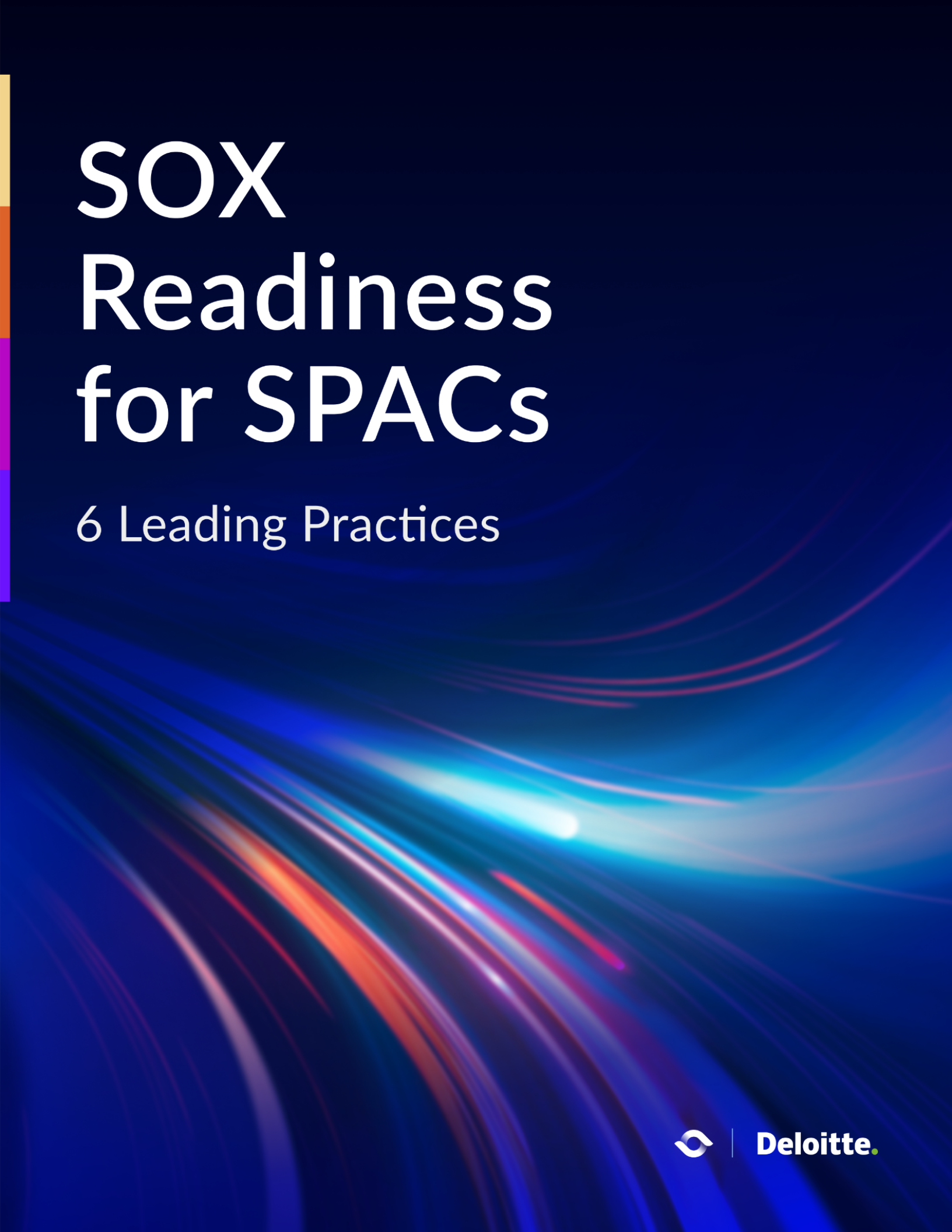
SOX Readiness for SPACs

6 Leading Practices



Deloitte.

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Introduction

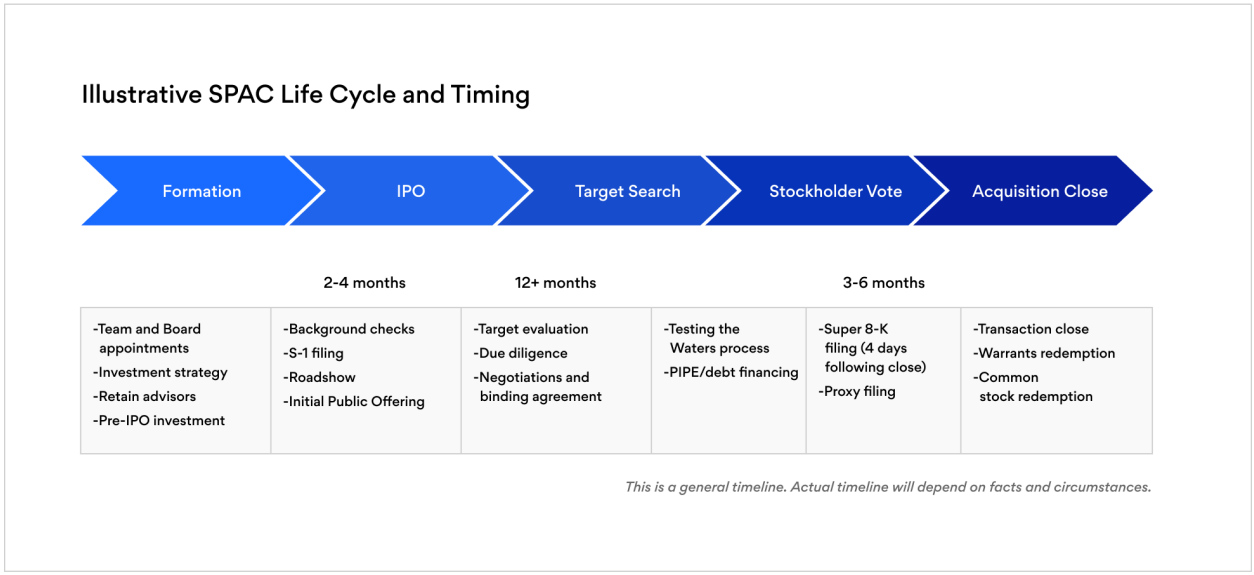
One of the most popular trending topics in capital markets this past year has been the rise of special purpose acquisition company (SPAC) initial public offerings (IPOs). Though SPACs have existed for decades, in 2020, they overtook traditional IPOs as the predominant route for private companies to go public. According to SPAC Analytics research, there was a 320% increase in SPAC IPOs between 2019 and 2020. In the first half of 2021 alone, SPAC IPOs accounted for 58% of total US IPOs. As the popularity of SPACs continues to sweep the investment world, it is important for potential SPAC stakeholders to understand the necessity of prioritizing SOX readiness when facing significantly accelerated SPAC timelines. This whitepaper will explore recognized practices for SOX readiness on a SPAC timeline.



Source: SPACanalytics.com, July 2021.

Background

A SPAC is a newly created company that uses a combination of IPO proceeds and additional funding — private investment in public equity (PIPE) fundraising has been common in recent times — to fund the acquisition of a private operating company. The proceeds raised in the IPO are placed in a trust account while the SPAC's management team seeks to complete an acquisition of an existing operating company ("target"), generally in a specific industry or geography, within the period stated in the SPAC's governing documents (typically, 18 to 24 months). If the SPAC successfully completes an acquisition, the private operating company target succeeds to the SPAC's public filing status, and, as a result, the target effectively becomes a public company. After a target company has completed its SPAC merger and is publicly listed, it is known as a "De-SPACed" company. If the SPAC is unable to complete an acquisition in the allotted time frame, the cash held in its trust account is returned to its investors unless the SPAC extends its timeline via a proxy process. The following is a sample timeline.



Source: Deloitte.

Differences Between Traditional IPOs and SPAC IPOs

The traditional IPO was the dominant vehicle for private companies looking to go public until the tides began to shift in 2019, the start of a period of hyper growth for SPACs.[1] By 2020, the number of SPACs outnumbered traditional IPOs, and investment capital raised by SPACs was up more than 500% from 2019.[2] While both a traditional IPO and a SPAC IPO deliver the same end result (a public market for exit) the following outlines notable differences between the two.

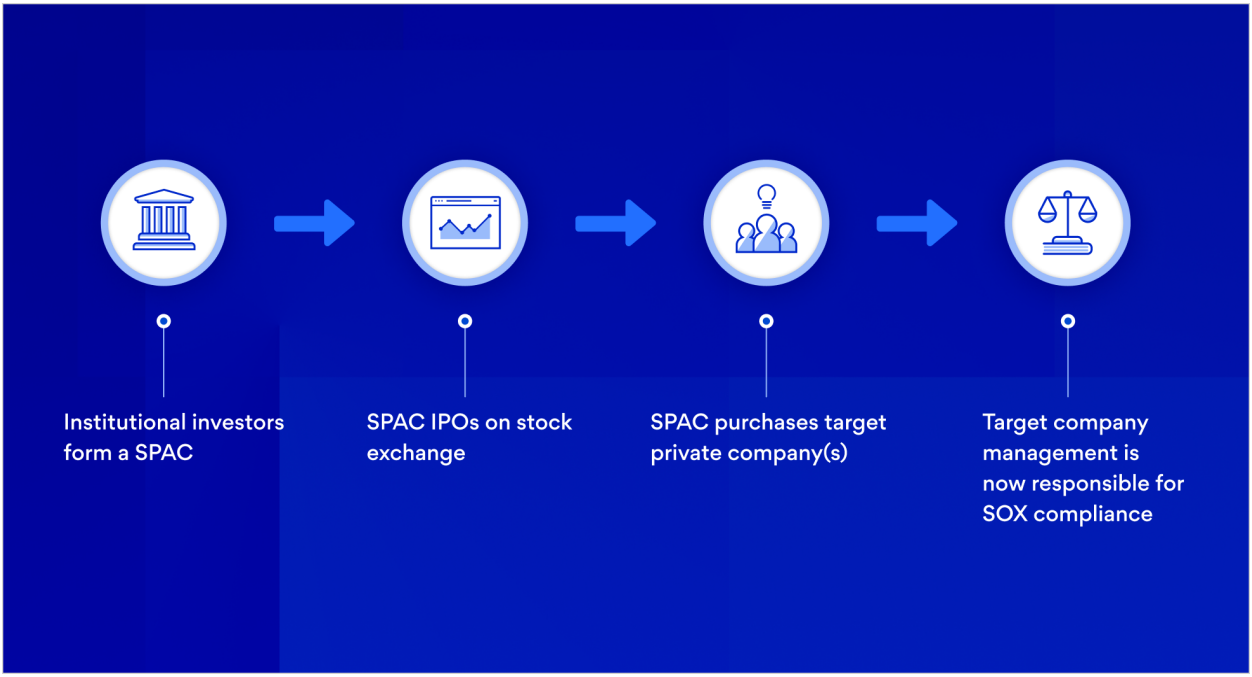
Traditional IPO	SPAC IPO
Public market for exit	Public market for exit
Time intensive, multiple key investors, pitched via roadshow	• Though time intensive, generally quicker and more efficient means to go public • Companies deal with one sponsor rather than completing a roadshow for investors
Generally more valuation risk and less price certainty as dependent upon market demand	• Generally less valuation risk, upfront price certainty as valuation is negotiated up front between SPAC seller and sponsor • Target company may have negotiation power if dealing with a late-stage SPAC
Underwriters typically receive a discount of 1%–7% of the gross IPO proceeds	• Discount structure is 2% to underwriters when the SPAC IPOs, and another 3.5% when the SPAC transaction is completed • Potential to pay more investment banking fees for the merger with the company
Requires SEC filings, review, and disclosures and public company PCAOB financial statements	Requires SEC filings, review, and disclosures and public company PCAOB financial statements
Generally 180 day lock-up period	Generally 1 year lock-up period (seller lock-up)

[1] Deloitte, "A primer on SPACs: Risks and trends amid a shifting IPO landscape," 2021.
[2] SPACanalytics.com.

Preparing for SOX Ahead of Your SPAC Merger

"A SPAC merger offers an alternative vehicle to target companies who may not have wanted to go public with a traditional IPO for a variety of reasons. My advice for target company executives would be to think and plan ahead for the public company filing and other requirements from a talent, technology, and process point of view."

– Ashok Parmar, Partner, Deloitte & Touche LLP



Companies that go public through a SPAC merger are required to meet the same regulatory requirements as pre-IPO companies, but in a much shorter time frame. One of the key requirements for public companies (in terms of resources, time-intensiveness, and overall costliness) is Sarbanes-Oxley (SOX) compliance. Under the SOX Act of 2002, public companies are required to document, test, and certify their internal controls over financial reporting. The purpose of SOX compliance is to protect shareholders' interests and prevent corporate accounting fraud by holding public company executives accountable for their financial

statements. Noncompliance with SOX may have detrimental consequences for public companies, including fines, prison time for CFOs and CEOs, removal from listing on public stock exchanges, and more.

Preparing to be SOX Compliant Timing



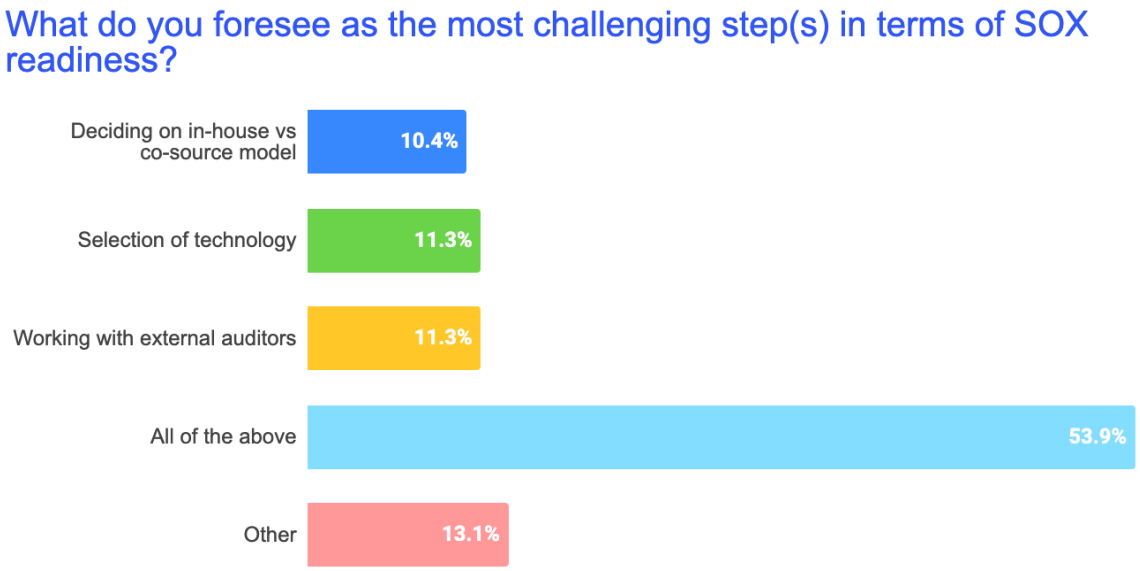
Time prior to SOX 404b Compliance

24 Months	22 Months	18 Months	12 Months	
			Form 10-K	Form 10-K SOX 404(a) and 404(b) Compliance

This is a general timeline. Actual timeline will depend on facts and circumstances.

While pre-IPO companies typically begin their SOX readiness activities up to a year before going public, the time for a SPAC to take a target company public (i.e., complete and finalize its merger and acquisition process) may take between three and four months. Though some de-SPACed companies are not required to be compliant with SOX 404a (management certification of controls) and 404b (internal control over financial reporting) until their second year public, preparing for a SOX audit is generally not feasible in a matter of weeks or even months. SOX readiness and SOX testing requires significant time and effort, including remediation of identified gaps and retesting to ensure the remediated controls are working properly.

A May 2021 AuditBoard poll asked more than 1,000 audit, risk, and compliance professionals what they foresee as the most challenging steps in preparing for SOX compliance. Nearly 54% of respondents stated that deciding how to model their program, selecting a technology solution, and working with external auditors were nearly equally challenging aspects of SOX readiness.



Source: AuditBoard Poll, May 2021.

As such, an overall recognized leading practice for SPACs is to begin SOX readiness activities as early as possible, rather than waiting until after the acquisition is complete. This urgency is tied to the negative consequences of noncompliance, which may severely impair business growth and investor confidence. SPAC stakeholders, from the sponsor to its target company to its investors, ultimately benefit from investing in SOX readiness early on.

6 Leading Practices for SPAC Targets to Prepare for SOX

The following are several strategies to incorporate SOX readiness ahead of your SPAC merger so you may hit the ground running once you are a de-SPACed company.

1. **Perform a gap assessment.** Before the letter of intent is signed, perform a self-assessment to identify key accounts, processes, systems, locations, and third-party relationships and identify the major gaps in your organization that could lead to a material misstatement. Familiarize yourself with the timelines of SOX planning, testing, and reporting processes and draw up a general road map calendar. Document your findings in a detailed SOX program project document so that you may reference this information during PIPE presentations and when meeting with your SOX advisor and external auditor.

2. **Appoint leadership and structure.** If not already determined, take advantage of the 30-day period after your proxy statement is filed, while waiting for comments from the SEC, to identify resources and consider how to frame and structure your SOX program. This is a good time to identify who may likely lead your organization's SOX program and what their team may likely look like, as well as how this likely factors in with other requirements for going public (e.g., IT environment, corporate governance, operations).

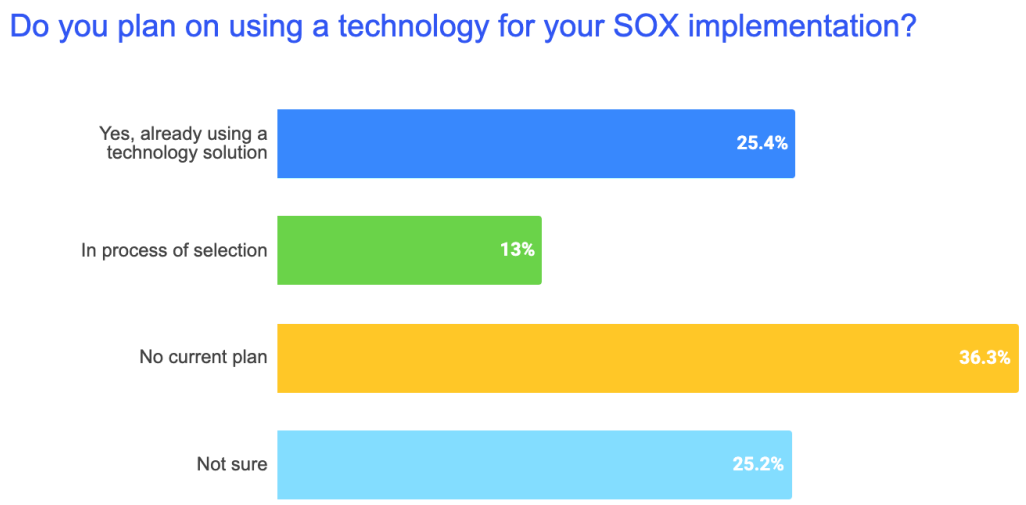
3. **Engage with experienced advisors.** After outlining your SOX program project document, identify an advisor with SOX experience — typically an accounting firm — to advise you on navigating the initial period of preparing for SOX (this does not apply if you are a large, mature company that has been preparing to go public and is ready). Work with your advisor and your independent external auditors to understand the key areas to focus on in your SOX program, as well as your expected timeline and budget for SOX.

4. **Perform a Risk Assessment.** A robust risk assessment can enable an organization to implement the appropriate controls, resulting in an optimal SOX program. Components of a robust risk assessment include consideration of characteristics of the business, relevant accounting and financial reporting frameworks, significant acquisitions or dispositions, and the nature of internal business processes. A thorough risk assessment, including a detailed scoping analysis, may provide valuable information and save time on internal control identification and testing. Consideration should also be given to emerging issues such as cyber risks; business continuity planning; and environmental, social and governance issues.

5. **Budget SOX Costs into Your PIPE Presentations.** As your business grows, you should also be prepared to spend more on your annual SOX compliance costs. For context, the average cost of SOX compliance for businesses with one to three unique locations was $975,900, according to Protiviti's 2021 SOX Compliance Survey conducted in March 2021. Typically, PIPE investors are familiar with the necessity and benefits of SOX and likely understand the SOX compliance costs incorporated into your budget.

6. **Consider Implementing Technology from the Start.** One of the biggest pain points for a company standing up its SOX program using the traditional method of spreadsheets, documents, presentations, and shared drives is inefficiency and a general lack of consistency. An effective way to combat the administrative burden of managing SOX is to leverage a SOX technology solution when building out your control environment. The right technology may help to centralize documentation in a single source of truth; streamline and automate planning, testing, and reporting workflows; and help to unify SOX stakeholders in one location to collaborate and work efficiently. Researching and performing due diligence on technology solutions early on is also useful because you may include SOX costs in the budget of your PIPE presentations.

25% of professionals surveyed are using technology for their SOX implementation.



Source: AuditBoard Poll, May 2021.

Conclusion: Be Mindful of Your Timing

In addition to becoming SOX-ready, SPACs have many priorities ahead of closing an acquisition. As such, SPACs and their target companies should be on the lookout for any efficiencies that may be incorporated into their SOX readiness program, including integrating SOX compliance into their business early on. Considering the variety of promising technologies available to SOX practitioners, SPAC target companies likely benefit from researching and performing due diligence on SOX data and technology solutions soon after signing an LOI. Moreover, the timing of technology adoption may represent the difference between a SOX program that flourishes soon after launching and a SOX program that quickly becomes unmanageable and inefficient. Seek to identify a solution (or set of solutions) that likely optimize your time savings and represent a clear return on investment as quickly as possible. Ultimately, building a centralized and organized environment to house your SOX data and communications from the start will likely ease the process of helping your public company reach its requirement for SOX compliance.

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About

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