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SPACs Headed for New Wave of Restatements for Accounting Errors

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- Latest accounting issue deals with classification of certain shares
- Regulators expecting restatements

The Securities and Exchange Commission will require blank-check companies known as SPACs to restate their financial results because they incorrectly followed accounting rules on how to classify certain shares they offer to investors, according to auditors and advisers of those companies.

The errors mark the latest regulatory intervention that could affect hundreds of special purpose acquisition companies, which are formed solely to buy other companies and take them public. SPACs surged in popularity in 2020 but regulators have pledged tougher scrutiny of them.

The issue has been bubbling for months, but most audit firms considered the errors small enough to be fixable with a revision, a minor correction that gets disclosed in the next period's financial statement. The SEC, however, told firms last week that such a correction isn't enough, said David Bukzin, vice chairman of Marcum LLP, the firm that's audited the most SPAC IPOs in 2021 according to SPAC Research.

SPACs must instead call attention to the past error with a so-called "big R" restatement—a more serious kind of correction that requires a company to file an 8K form spelling out that prior financial statements can't be relied on. The errors could temporarily pause the market as SPACs deal with a paperwork backlog.

"This is a pervasive issue; everyone's dealing with it because everyone did it wrong," said Scott Norris, principal at UHY LLP.

The SEC didn't comment on a question about how the agency was telling SPACs how to fix their accounting mistakes. Under U.S. accounting rules outlined in ASC 250, if a company's financial statements contain a material error, the company must determine whether they need to restate.

The share classification errors mark the second time this year accounting snafus stymied special purpose acquisition companies. In April, the SEC staff threw sand in the gears of the surging market when it warned that SPACs weren't accounting correctly for investor incentives called warrants. Hundreds of restatements followed.

SPACs typically issue two types of shares: founder shares and Class A shares. Class A shares are redeemable, meaning that investors can ask for their money back if they don't like a company the SPAC targets to take public. This feature is a key part of what makes SPACs attractive to early investors: if they aren't happy with the merger, they don't lose their money.

The new accounting issue is that SPACs for years have incorrectly treated Class A shares as permanent equity instead of temporary equity, auditors said.

"Many of the auditing firms took the position that it was a little R," Bukzin said, referring to a revision. "But the SEC came back and made it clear that they believe it's a big R."

According to Marcum, the SEC won't require SPACs to amend their old 10Qs, as is the case with typical "Big R" restatements. Instead, SPACs can offer details about the corrections in their next filing, Bukzin said the SEC told his firm. It is unclear how the regulator will require corrections for past annual financial statements.

At least two SPACs already have issued Big R restatements. D and Z Media Acquisition Corp. on Friday evening and Mercury Ecommerce Acquisition Corp. on Nov. 4 filed 8Ks calling attention to their accounting errors.

The latest accounting errors do not affect the cash or the economics of a SPAC. Compared to the warrant classification issue that halted the SPAC IPO market this spring, the equity classification issue isn't likely to cause as much of a disruption, Bukzin said.

"It's putting additional burdensome requirements on SPAC teams on a tight time table to meet their filing obligations," he said.

That's because most SPACs need to maintain tangible assets of a certain amount to consummate a business combination. If their permanent equity dips, it can tie up a deal.

Accounting rules under ASC 480 state that if an equity instrument is redeemable and this redemption feature is outside the control of the company, that instrument can't be considered permanent, said Graham Dyer, partner at Grant Thornton LLP.

"Clients we have audited, we have said every Class A share needs to be temporary equity," Dyer said. Grant Thornton audited 11 SPAC IPOs in 2021, less than 2% of all SPACs, according to SPAC Research.

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