

ASK THE EXPERTS WEBINAR

*Fitting Internal Controls and SOX within
the IPO Roadmap*

November 11, 2021

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KEY REMINDERS

- ▶ Riveron webcasts – past and upcoming – www.riveron.com
- ▶ 4 polling questions must be answered to obtain CPE
- ▶ If you have questions, feel free to ask in Q&A option in Zoom
- ▶ Webinar evaluation form & CPE certificate will be emailed to you
- ▶ On demand video is not eligible for CPE
- ▶ You will receive a follow up email including:
 - ▶ Access to this webinar recording and deck
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Polling Question #1

How is SOX relevant to your organization?

- A. Private company preparing for IPO
- B. Public company not yet SOX compliant
- C. Public company and SOX compliant
- D. Public company remediating a material weakness
- E. Not applicable / other

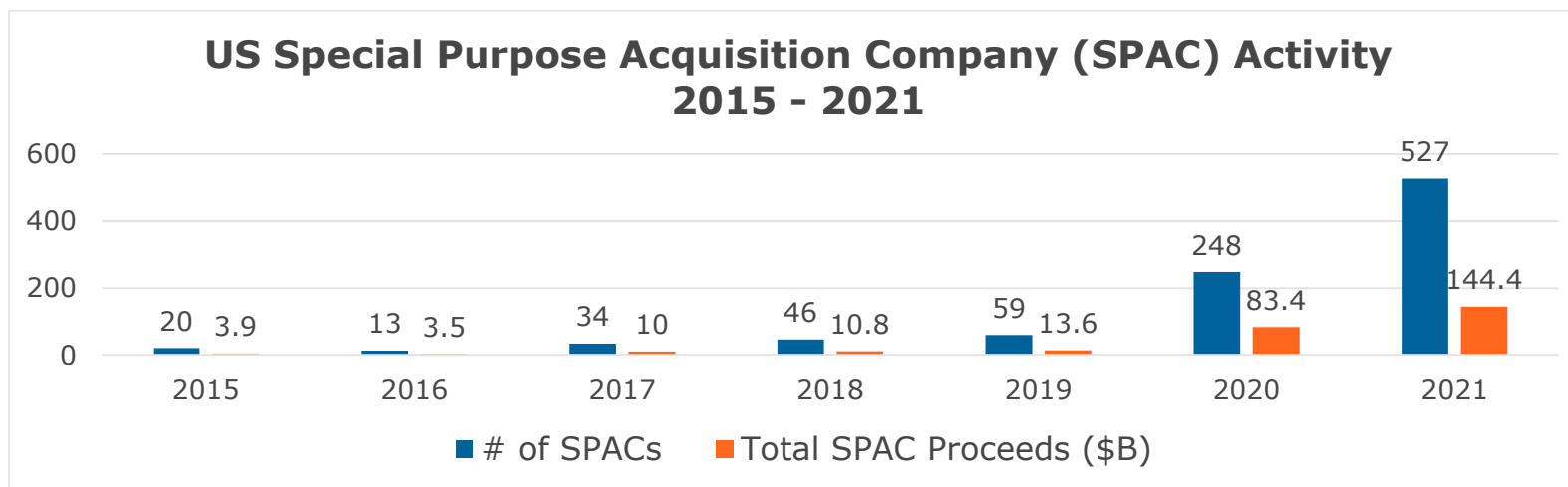
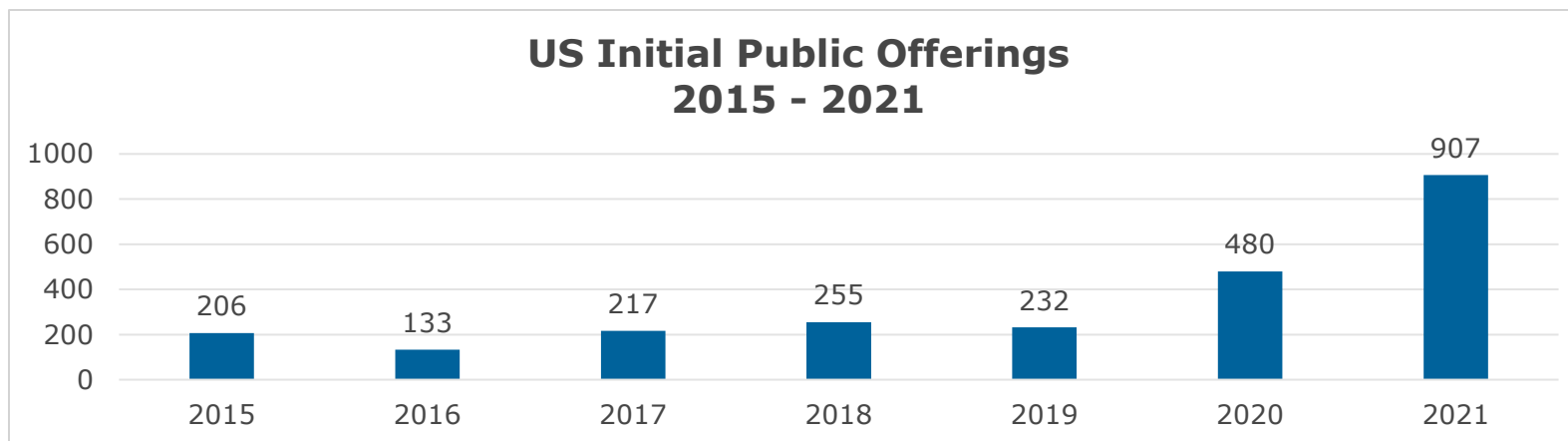




THE PATHS TO SOX COMPLIANCE

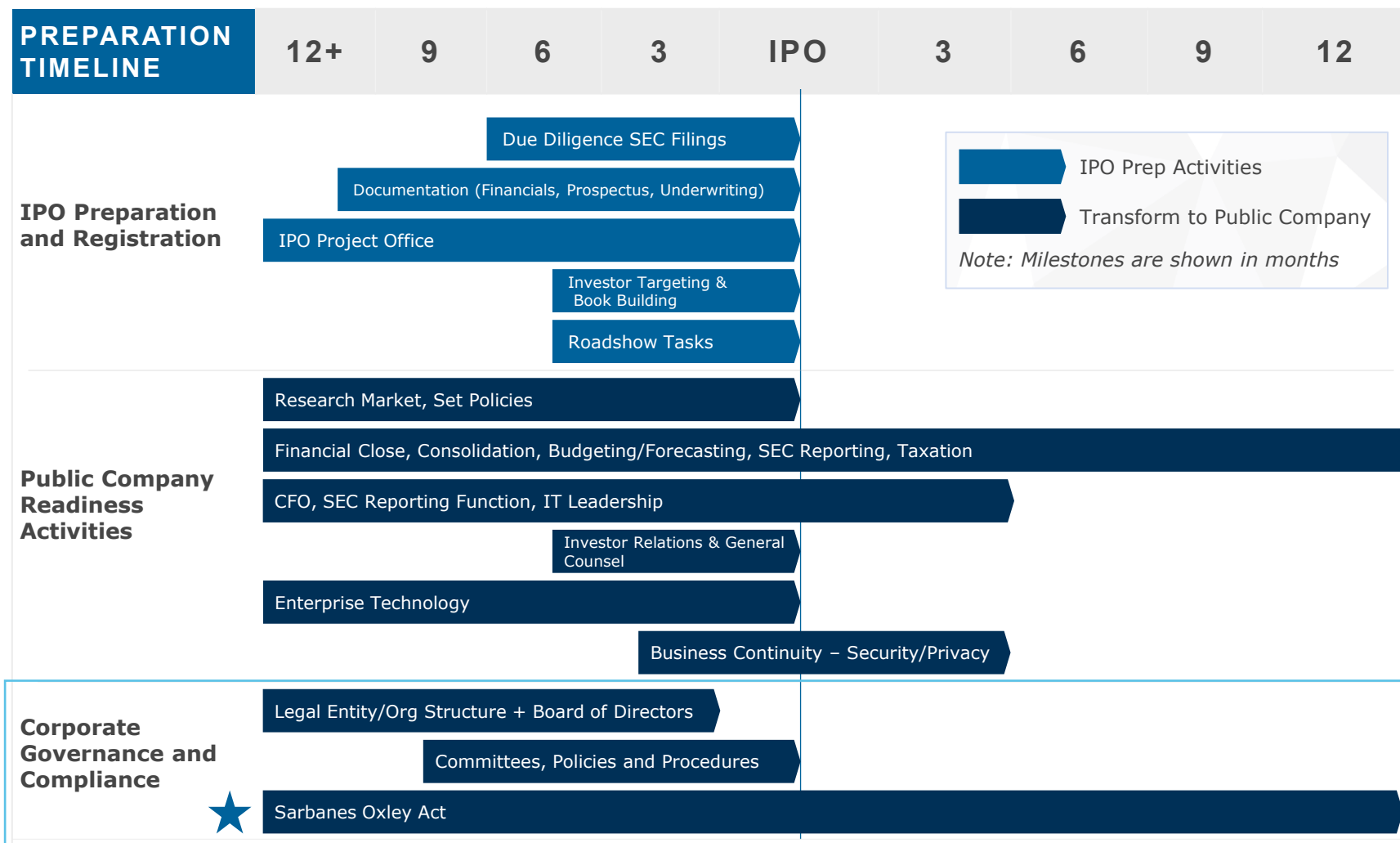
*Defining your timeline and
certification requirements*

WHY IS THIS TOPIC RELEVANT TODAY?



Source: StockAnalysis.com; Spac Research.com

EXAMPLE OF A TRANSFORMATION TO A PUBLIC COMPANY



KEY SECTIONS OF SOX

A summary of key certification requirements

Section	Details	What does this mean?
302	Corporate Responsibility for Financial Reports	<p>The CEO and CFO must personally certify that:</p> <ul style="list-style-type: none"> ▶ He/she has read the report ▶ The report contains no material misstatements or omissions ▶ The financial statements and other financial information fairly present in all material respects the financial condition, results of operations and cash flows of the company as of and for the periods presented in the report
906	Corporate Responsibility for Financial Reports	<p>Each periodic report containing financial statements must be accompanied by a statement from the CEO and CFO certifying that:</p> <ul style="list-style-type: none"> ▶ The report fully complies with the requirements of the Exchange Act ▶ The information contained fairly presents in all material respects the financial condition and results of operations of the company
404 A/B	Management Assessment of Internal Controls and Auditor Attestation of Internal Controls	<p>Each 10-K must include:</p> <ul style="list-style-type: none"> ▶ A statement of management's responsibility for establishing and maintaining adequate Internal Control over Financial Reporting (ICFR) for the company ▶ A statement identifying the framework used by management to evaluate the effectiveness of ICFR ▶ An assessment by management of the effectiveness of ICFR as of the end of the most recent fiscal year, including a statement as to whether ICFR is effective ▶ A statement that the auditors of the financial statements included in the report have issued an audit report on the effectiveness of ICFR

STANDARD SOX READINESS TIMELINE

PRE-IPO	IPO YEAR	YEAR 1	BEYOND YEAR 1
Years leading up to the IPO	IPO year First partial year as a public company	First 10-K, year leading up to 404 certification	Future years as a public company
SOX readiness	Preliminary SOX testing	Remediation and final SOX testing	First 404 opinion & ongoing SOX maintenance
SOX readiness <ul style="list-style-type: none"> ▶ Establish documentation and testing efforts, and internal audit. ▶ Set up Disclosure Committee and process supporting Section 302 & 906 certifications. 	IPO year <ul style="list-style-type: none"> ▶ Disclose known material weaknesses in Form S-1 - appropriate risk factor. ▶ Continue documentation efforts. ▶ Complete initial testing and focus on remediation activities. ▶ File 10-Qs, including Section 302 & 906 certifications. 	Prepare for first 404 opinion <ul style="list-style-type: none"> ▶ File first 10-K, continue filing 10-Qs, including Section 302 & 906 certifications. ▶ Complete documentation and remediation by mid-year of all control gaps. ▶ Enhance level of management testing to support Section 404 certification. ▶ Optimize control structure; increase controls reliance further for financial audit. 	First and ongoing 404 opinions <ul style="list-style-type: none"> ▶ Continue filing public financial reports, including Section 302 & 906 certifications. ▶ Management's report on the effectiveness of internal controls over financial reporting is due in the Form 10-K. ▶ Auditor opinion on the effectiveness of internal controls over financial reporting is due once company no longer qualifies as EGC (up to 5 years after IPO). ▶ Optimize control structure; increase controls reliance further for financial audit.

YOU'VE GONE PUBLIC: NOW WHAT?

Your public float dictates what category of filer your company is and when you are required to be SOX compliant.

Category of Filer	SOX Compliant Timeline	Requirements	Reporting Criteria
Emerging Growth Company (EGC)	1 – 5 years	<ul style="list-style-type: none"> ▶ Annual gross revenues of less than \$1B during its most recently completed fiscal year ▶ Has not issued nonconvertible debt in excess of \$1B during the most recent three-year period 	<ul style="list-style-type: none"> ▶ Exempt from 404(b) attestation for up to 5 years ▶ Review public float calculation to revisit EGC status
Large Accelerated Filer	1 year	<ul style="list-style-type: none"> ▶ The issuer had an aggregate worldwide market value of the voting and nonvoting common equity held by its non-affiliates of \$700M or more, as of the last business day of the issuer's most recently completed second fiscal quarter ▶ The issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least 12 calendar months ▶ The issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act ▶ The issuer is not eligible to use the requirements for smaller reporting companies in Part 229 of the Exchange Act for its annual and quarterly reports 	<ul style="list-style-type: none"> ▶ 10-K: 60 days after fiscal year-end ▶ 10-Q: 40 days after fiscal quarter-end ▶ Management's report and auditor's attestation required at the second annual report
Accelerated Filer		<ul style="list-style-type: none"> ▶ The issuer had an aggregate market value held by non-affiliates of at least \$250M but less than \$700M as of the last business day of the most recent Q2 (unless the issuer was previously a large accelerated filer, in which case the range is \$50M to less than \$500M) 	<ul style="list-style-type: none"> ▶ 10-K: 75 days after fiscal year-end ▶ 10-Q: 40 days after fiscal quarter-end ▶ Management's report and auditor's attestation required at the second annual report**

Polling Question #2

What is your experience working in a SOX compliant environment?

- A. 0-1 years
- B. 2-4 years
- C. 5+ years



AREAS OF FOCUS - SOX READINESS

*How we guide our clients
through this process*

PHASED APPROACH TO SOX READINESS

Phase 1: Risk Assessment & Scoping

- ▶ A comprehensive top-down risk assessment can help organizations identify the areas of utmost importance to its overall control environment

Phase 2: Documentation, Walkthroughs, Control Design

- ▶ Understanding the design of our control environment, and furthermore, documenting it helps ensure effective risk mitigation, while also conveying expectations to pertinent personnel

Phase 3: Remediation

- ▶ Addressing areas of known deficiency is an art not a science. Informing remediation with other strategic initiatives can help prevent issues in execution

Phase 4: Control Testing

- ▶ Operational effectiveness testing helps inform management on the current state of their control environment from both a design and operational effectiveness perspective

Phase 5: Reporting

- ▶ Keeping shareholders abreast of an organization's control environment is the responsibility of the executive management team. A detailed SOX 302 sub-certification process can help ensure that shareholders are kept informed of all material changes to the organization's control environment

COMMON SCENARIOS THAT INCREASE LIKELIHOOD OF SIGNIFICANT DEFICIENCY OR MATERIAL WEAKNESS



Technology Implementation/ITGC



**Business Combinations /
Divestitures or other significant
transactions**



**Qualifications and/or Turnover
of Key Company Personnel**



**Complex Accounting
Topics/Emerging Issues**



**Inadequate Segregation of
Duties or Monitoring Controls**



**Failure to Address Completeness
and Accuracy**

COMMON SCENARIOS

TECHNOLOGY IMPLEMENTATION /ITGC

Potential remediation actions or preventative measures to consider:

- ▶ Implementing change management controls will minimize disruptions, alterations and errors to an IT environment.
- ▶ Periodically rationalizing access privileges for all system users.
- ▶ Ensuring data integrity prior to data migration.
- ▶ Identifying all key reports generated out of the new system and ensuring effective completeness and accuracy.
- ▶ Ensuring controls are designed to address relevant risks when implementing new systems (i.e., ERP) as well as integrating existing systems.

A Luxury Brand Name Shoe Designer and Seller

Practical Illustration in the Form 10-K/A for the Year Ended 12/31/2017

"We did not design and implement effective control over risk assessment with regard to certain processes and procedures commensurate with our financial reporting requirements which we determined to be a material weakness. **Specifically, we did not design and maintain adequate information technology general controls (ITGCs) for information systems that are relevant to the preparation of financial statements** in the following areas: **administrative user access to the Company's wholesale, retail and operating systems to ensure appropriate segregation of duties and to adequately restrict access to financial applications and data; and program change management controls to ensure that information technology program and data changes affecting financial IT applications and underlying accounting records were tested, approved and implemented appropriately.**"

COMMON SCENARIOS

BUSINESS COMBINATIONS OR DIVESTITURES / OTHER SIGNIFICANT TRANSACTIONS

Potential remediation actions or preventative measures to consider:

- ▶ Business integration efforts should include focus on standardizing controls across newly acquired business units.
- ▶ Transactions often give rise to technical accounting, financial reporting and valuation matters. Engaging with third party specialists can help provide guidance on complex transactions.
- ▶ Risk assessments should be refreshed to incorporate impact of business transactions on risk management program.

Aerospace & Defense Government Contractor

Practical Illustration in the Form 10K for the Year Ended 9/30/2014

"The Company identified a material weakness in the operation of its internal control over financial reporting (as such term is defined in Rule 15(d)-15(f) under the Exchange Act). **The material weakness related exclusively to recording elements of the Company's recent Refinancing Transactions, in particular, the Company's recently issued Third Lien Notes.** The Refinancing Transactions required multiple reviews and analyses of complex accounting principles and interpretations. In its effort to account for the Refinancing Transactions, management relied, in part, on the Company's outside advisors' description and interpretation of some of the newly issued debt instruments. **Management did not engage a third party which specializes in the accounting treatment associated with complex capital transactions to analyze the multiple components of the Refinancing Transactions.** In the future, management will engage third party specialists to provide assistance and guidance, if and when, the Company executes any future complex capital transactions."

COMMON SCENARIOS

QUALIFICATIONS AND/OR TURNOVER OF ACCOUNTING/ FINANCE PERSONNEL

Potential remediation actions or preventative measures to consider:

- ▶ Hiring an appropriate number and level of experienced accounting and finance resources with the required technical acumen.
- ▶ Transitioning control ownership upon departure of key accounting personnel.
- ▶ Retaining and transferring knowledge in times of heavy turnover.
- ▶ Reducing key person dependencies by cross training employees.

A Hydrogen Fuel Cell Company

Practical Illustration in the Form 10K for the Year Ended 12/31/2020

- ▶ "Management identified the following deficiency in internal control over financial reporting as of December 31, 2020: **the Company did not maintain a sufficient complement of trained, knowledgeable resources to execute its responsibilities with respect to internal control over financial reporting for certain financial statement accounts and disclosures. As a consequence, the Company did not conduct an effective risk assessment process that was responsive to changes in the Company's operating environment and did not design and implement effective process-level controls activities** in the following areas: presentation of operating expenses; accounting for lease-related transactions; identification and evaluation of impairment, accrual for loss contracts, certain expense accruals and deemed dividends; timely identification of adjustments to physical inventory in interim periods.
- ▶ **Certain of these deficiencies resulted in material misstatements** that were identified and corrected in the consolidated financial statements...."

COMMON SCENARIOS

COMPLEX ACCOUNTING TOP ICS / EMERGING ISSUES

Potential remediation actions or preventative measures to consider:

- ▶ Companies should keep up to date on new/emerging accounting topics and update necessary accounting policies.
- ▶ Companies should work closely with their auditors and consultants to ensure proper accounting for complex topics.
- ▶ Hire qualified staff with technical expertise.

A Digital Sports Entertainment and Gaming Company

Practical Illustration in the Form 10-K/A for the Year Ended 12/31/2020

- ▶ “Subsequent to, and as a result of that restatement, **the Company has concluded that there was a material weakness in its operation of controls over the classification and accounting for the Assumed Warrants in accordance with Accounting Standards Codification 815-40**
- ▶ **To remediate the material weakness, we studied and clarified our understanding of the accounting for contracts that may be settled in the Company’s own stock, such as warrants, as highlighted in the SEC Statement and enhanced the accounting policy, controls and procedures related to the accounting for such contracts to determine proper accounting in accordance with U.S. GAAP as clarified by the SEC Statement.”**

COMMON SCENARIOS

INADEQUATE SEGREGATIONS OF DUTIES, OR MONITORING CONTROLS

Potential remediation actions or preventative measures to consider:

- ▶ Reviewing headcount constraints which could give rise to ineffectively segregated critical responsibilities, such as an individual approving a purchase order they initiated.
- ▶ Implementing compensating/mitigating controls such as performing reconciliations, maintaining audit trails and transactions logs, supervisory reviews.
- ▶ Ensuring effective monitoring of activities by adding management review controls.

A Provider of Rental Vehicles to Drivers Who Work for Ridesharing Companies

Practical Illustration in the Form 10-K/A for the Year Ended 12/31/2019

- ▶ **“We do not have sufficient segregation of duties within accounting functions, which is a basic internal control.** Due to our size and nature, segregation of all conflicting duties may not always be possible and may not be economically feasible. However, to the extent possible, the initiation of transactions, the custody of assets and the recording of transactions should be performed by separate individuals. Management evaluated the impact of our failure to have segregation of duties on our assessment of our disclosure controls and procedures and **has concluded that the control deficiency that resulted represented a material weakness.**
- ▶ **In fiscal 2020, the Company plans to hire additional accounting and finance staff to address the material weakness identified herein.”**

COMMON SCENARIOS

FAILURE TO ADDRESS COMPLETENESS & ACCURACY

Potential remediation actions or preventative measures to consider:

- ▶ Understanding, inventorying and categorizing the information produced by the entity (IPE), including source data, report logic and report parameters.
- ▶ Validating the completeness and accuracy of the information used in a control (IUC) by tying back to data sources.
- ▶ Documenting supervisory review and approval of manual procedures such as reviewing formulas in a spreadsheet and reperforming complex calculations

A SaaS Company for Collaboration and Work Management

Practical Illustration in the Form 10-K for the Year Ended 1/31/2020

"We did not design and maintain effective controls relating to the completeness, accuracy and occurrence of order entry and pricing during our billing and revenue processes."

Polling Question #3

How confident are you that your organization effectively assesses and mitigates access risk?

- A. Very Confident
- B. Not Very Confident
- C. Unsure
- D. Everyone has access to everything

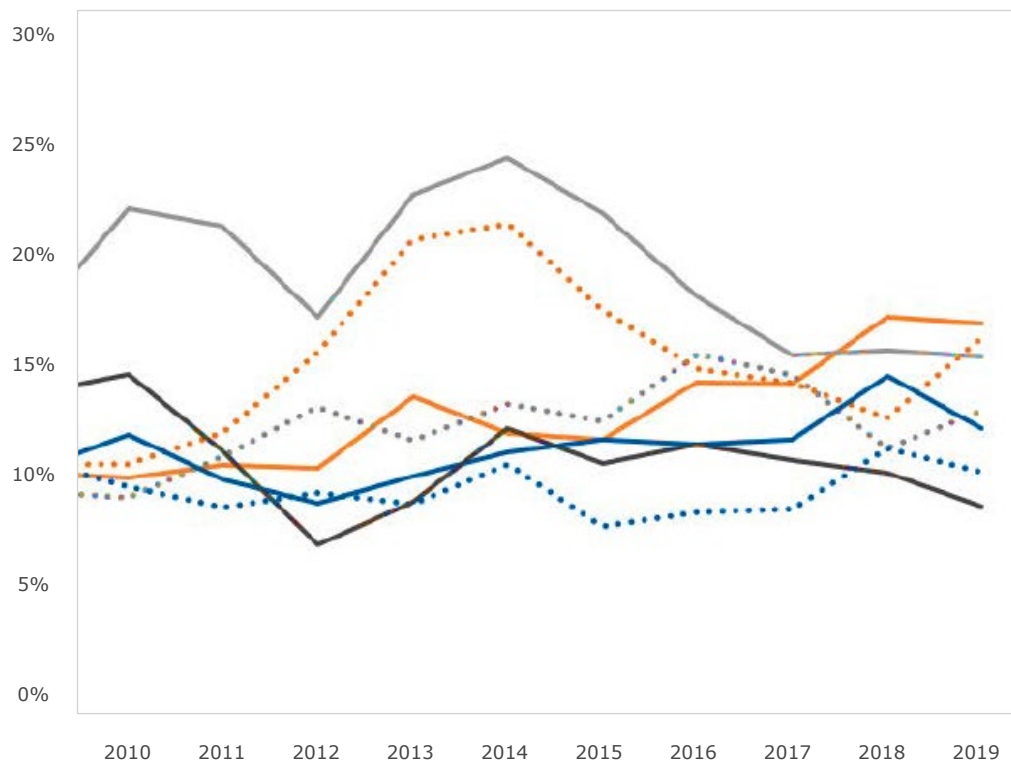











AREAS OF FOCUS - TAX

FREQUENCY OF ISSUES OCCURRENT IN RESTATEMENTS

Historical Percentage of Seven Issues in 2019



	Revenue Recognition Issues
	Debt, quasi-debt, warrants & equity (BCF) security issues
	Liabilities, payables, reserves and accrual estimate failures
	Expense (payroll, SGA, other) recording issues
	Cash flow statement (SFAS 95) classification errors
	Tax expense / benefit / deferral / other (FAS 109) issues
	Accounts/loans receivable, investments & cash issues

TAX – COMMON CLIENT CHALLENGES

1.

**LACK OF INTERNAL
COMMUNICATION**

2.

COMPRESSED TIMELINE

3.

**RELIANCE ON MANUAL
SYSTEMS**

4.

**LACK OF INTERNAL
RESOURCES WITH TAX
PROVISION EXPERTISE**

TAX – WAYS TO PREVENT OR REMEDIATE



Pre-close meeting

- ▶ Include accounting, treasury, legal and international team members
- ▶ Discuss unusual transactions
- ▶ Identify new lines of business/revenue/GL accounts
- ▶ Agree to timeline



Accelerate work

- ▶ Calculate depreciation and amortization
- ▶ Analyze any gain/loss on disposals
- ▶ Use actuals +1 month forecast for some book/tax differences



Maintain tax account reconciliations

- ▶ Prove out payable and receivable balances
- ▶ Do not just roll forward the account activity



Assign appropriate resources

- ▶ Internal staff
- ▶ External review

TAX – REAL LIFE EXAMPLES

1.

Material Weakness "MW" in Tax, SAAS Company -unable to prove out Income Taxes Payable

2.

Significant Deficiency in Tax, Retail Company – incorrect treatment of one-time item and foreign tax provision based on IFRS

3.

Recent MW disclosures -

- ▶ Inadequate internal controls
- ▶ Measurement of valuation allowance
- ▶ To remediate, increase review of tax calculation including use of external experts

Polling Question #4

Which of the following processes represents the highest risk at your organization?

- A. Tech Implementation
- B. Business Combinations or Divestitures
- C. Turnover of Accounting Personnel
- D. Adoption of New Accounting Standards
- E. Completeness & Accuracy

Q&A

ADDITIONAL RESOURCES



RELATED THOUGHT LEADERSHIP

[Three Ways to Prepare for an Internal Controls Audit in a Year of Significant Change](#)

[Five Common Scenarios That Can Lead to a Material Weakness](#)

[Modern Finance: Maximizing Operations at Newly Public Companies and SPACs](#)

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