CONNOR GROUP

BUSINESS GUIDE

From Private to Public:
The IPO Readiness Series

Why Internal Controls Must Evolve – Not Just Exist – on the Path to IPO

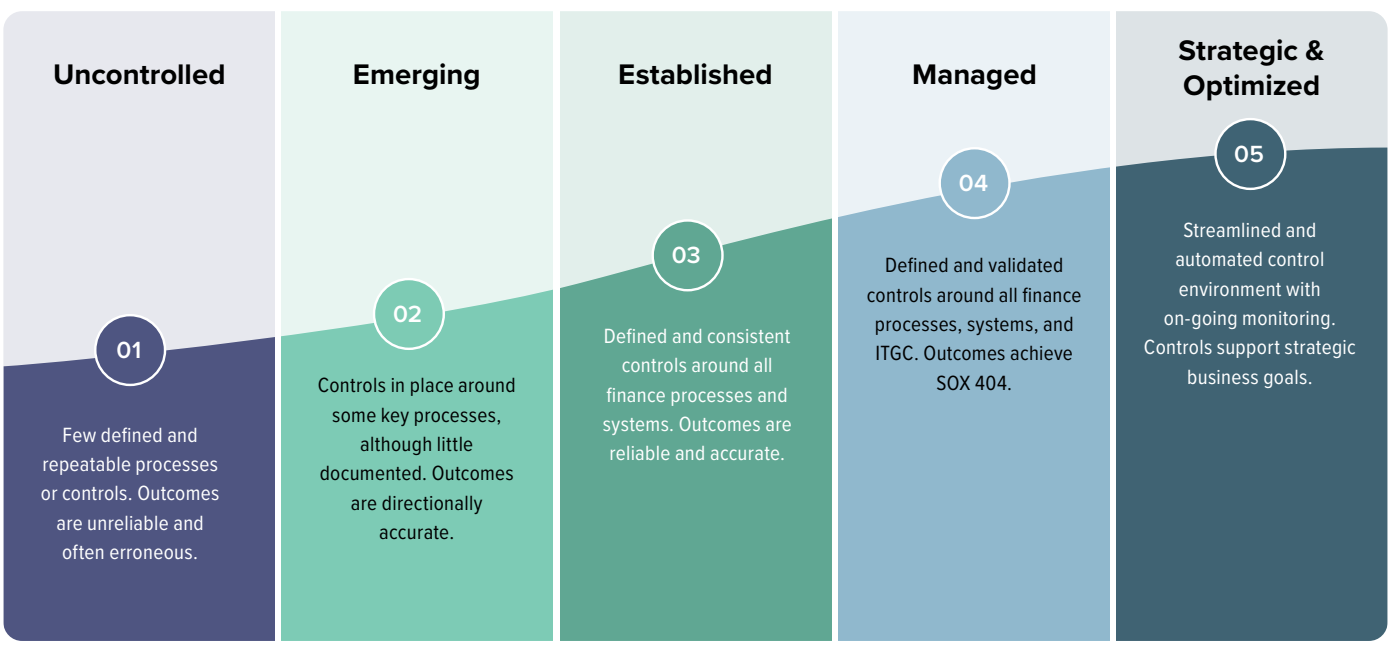
Internal controls are often viewed in binary terms – either you have them, or you don't. However, the reality is far more complex, with controls existing on a graduated scale of effectiveness and integration, particularly when looking ahead to the public markets.

As companies prepare for an IPO, it's critical to move away from a check-the-box mindset and instead adopt a proactive, strategic approach. Controls maturity isn't a one-size-fits-all exercise. It evolves based on a variety of factors, including:

- **Stage in the company lifecycle:** pre-IPO, newly public, high-growth, or mature
- **Industry dynamics:** regulatory complexity, market volatility, or operational risk profiles
- **Organizational culture and leadership style:** centralized vs. decentralized decision-making, risk appetite, and tone at the top

Our controls maturity model shows how we view the controls evolution, from an uncontrolled environment to a place where controls are built into and support a company's strategic processes.

SOX Maturity Model



What Does IPO-Ready Look Like?

To be IPO-ready, companies should not just install controls but embed them in the business. This means:

- **Standardized, scalable processes for key accounting, reporting, and operational activities**
- **Document and follow policies and procedures**
- **When possible, use automation and system controls to reduce reliance on manual processes**
- **Periodic testing and validation of controls performance**
- **Training and accountability across the organization**

Getting Started: Practical Steps Toward Controls Maturity

Companies gearing up for an IPO must first be clear about their current internal controls landscape. Decide what looks best for your organization and balance that against your ideal state of internal controls. Consider your growth trajectory, risk appetite, and post-IPO expectations. Remember, controls maturity is not about achieving perfection. It's about making consistent progress toward a scalable, sustainable framework that supports public company requirements.

The following roadmap provides actionable steps to ensure smooth and effective adoption:

#	Action	Why it Matters	Key Deliverables
1	Conduct Controls Readiness Assessment (Current State)	Establishes a baseline view of your control environment and highlights gaps against PCAOB expectations.	• Maturity scorecard • Priority gap list • Target state roadmap
2	Educate and Engage Cross-Functional Stakeholders	Finance, IT, and compliance teams must understand their day-to-day control obligations, while executives must be ready to sign SOX 302 and 906 certifications.	• Role-based training • Executive certification playbook
3	Build a Phased Implementation Roadmap and Execute Remediation	Early detection and remediation of control deficiencies prevent last-minute surprises and cost overruns. **Tip** - Not everything needs to be perfect on the first day. Sequence your efforts in phases. Start with high-impact controls and build toward a fully integrated framework.	• Gap tracker with owners and due dates
4	Fortify the Internal-Control Framework	Strong design and documentation are prerequisites for a clean audit opinion. **Tip** - Focus first on high-risk areas such as Financial Reporting, Revenue Recognition, IT General Controls (ITGC), and Segregation of Duties (SoD).	• Refined risk and control matrix (RCM) • Narratives and flowcharts
5	Stage a Mock Audit (Light Validation of Controls)	Pre-auditing the evidence lets you address issues before your auditor arrives, shortening fieldwork and improving the likelihood of a first-pass sign-off. **Tip** - Validate one sample of each key control already established for design and operating effectiveness.	• Mock audit report • Corrective-action log

Tips for Balancing Cost-Effectiveness with Strength of Controls

IPO-readiness doesn't require a perfect controls environment. The goal is to strike the right balance between fit-for-purpose controls and sensible investment.

Here are some practical steps:

- **Start with Risk-Based Prioritization**

  Focus on areas with the greatest financial impact or regulatory scrutiny first – like revenue, close processes, and IT general controls (ITGC).

- **Build for Scale, Not Perfection**

  Don't deploy overly complex controls. Design scalable processes that can evolve as the company grows.

- **Leverage Technology Wisely**

  Use existing systems to automate where possible. Build in system controls and reduce manual effort without excessive cost.

- **Use Interim Solutions Where Appropriate**

  Temporary manual controls or spreadsheets may suffice during early IPO stages if they are documented, consistently applied, and tested.

- **Embed Accountability, Not Just Checklists**

  Robust controls are about clear roles, consistent execution, and culture of accountability.

- **Review and Rationalize**

  Periodically reassess controls for redundancy or inefficiency.

Material Weaknesses in Internal Controls Over Financial Reporting (ICFR)

This can significantly impact a company's IPO journey, from regulatory scrutiny to investor confidence. Identifying and remediating these issues early is critical for companies considering going public.

Common Themes

- Lack of accounting and internal SEC reporting expertise
- Inadequate segregation of duties or over-reliance on a small finance team
- Deficient risk assessment processes, especially around complex or non-routine transactions
- Manual, spreadsheet-driven processes without robust review or automation
- Incomplete or ineffective control design or execution

Reporting in the S-1 Filing

- Description of the weakness(es)
- Potential impact on the financial statements
- Company's remediation plan and timeline

Considerations for Pre-IPO Remediation

- Can the issue be remediated and tested before the effective date?
- Will the timing of the IPO allow for retesting and auditor validation?
- How will the disclosure evolve if the issue remains unresolved?

Impact on Investor Confidence

- Trigger investor skepticism, especially among institutional investors focused on governance
- Affect pricing or increase risk premiums
- Raise concerns during analyst diligence or during follow-on offerings

Benefits of Early Preparation

- Helps uncover and address weaknesses before they require disclosure
- Reduces surprises during PCAOB audits
- Improves team confidence in financial reporting processes
- Builds investor trust and demonstrates management's commitment to strong governance

Understanding SOX 404(a) vs. SOX 404(b)

SOX 404(a): Management's Responsibility

Under SOX 404(a), management is responsible for establishing, maintaining, and assessing the effectiveness of internal controls over financial reporting (ICFR). Companies are required to disclose material weaknesses, but external auditor attestation is not mandatory.

SOX 404(b): External Auditor Attestation

SOX 404(b) requires an independent auditor to review and attest to the effectiveness of ICFR. This added level of oversight increases regulatory scrutiny and places a greater burden on companies to have well-documented, tested, and effective controls.

Key Differences

- **External Validation:** SOX 404(b) mandates independent auditor verification, unlike SOX 404(a). A company under SOX 404(a) may internally assess that its financial reporting systems are secure and free of material weaknesses. However, under SOX 404(b), an external auditor will independently test and verify this assessment.

- **Higher Standards:** Controls must withstand independent testing rather than just an internal evaluation. If a company under SOX 404(a) has a less formal approval process for certain transactions, it may pass management's review via some compensating controls. Under SOX 404(b), the auditor will likely require formalized policies, written documentation, and evidence of adherence to the process.

- **Greater Documentation Needs:** Companies must ensure rigorous control of documentation and testing procedures. Auditors pay close attention to areas where financial reporting accuracy can be compromised due to weak internal controls. Some critical areas include Segregation of Duties (SOD), IT General Controls (ITGC), and Management Review Controls (MRC).

SOX 302 and 906 Certification Requirements

As part of the broader SOX compliance framework, public companies must adhere to the certification requirements outlined in Sections 302 and 906 of the Sarbanes-Oxley Act. These provisions require CEOs and CFOs to personally certify the accuracy of financial statements and the effectiveness of internal controls.

- **SOX 302** requires executives to certify the completeness and reliability of quarterly and annual filings (such as Forms 10-Q and 10-K), affirming that disclosures fairly present the financial condition of the company.
- **SOX 906** further elevates the stakes by introducing criminal penalties for knowingly filing inaccurate or misleading financial reports.

Together, these certifications promote executive-level accountability and reinforce the integrity of financial reporting. When implemented alongside SOX 404 (a) and (b) internal control attestations, they form a cohesive compliance strategy that supports transparency, investor confidence, and regulatory trust.

Below is a comprehensive view of the various public company requirements around SOX certifications:

Certifications – Defined

Summary of sections 302, 906, 404(a) and 404(b)

	SECTION 302	SECTION 906	SECTION 404(a)	SECTION 404(b)
Certified by	CEO and CFO	CEO and CFO	Management	External Auditor
Summary Requirements	Certify to financial statement fairness and internal control effectiveness	Certify to financial statement fairness (criminal liability)	Annual internal control assessment	Annual attestation to managements internal control report
Timing	Quarterly in 10Q/K	Quarterly in 10Q/K	Annual in 10K	Annual in 10K
Applies to	All issuers	All issuers	All issuers [1] [3]	Accelerate filers [1] [2]

[1] First year exemption for new public issuers

[2] Emerging Growth Company (EGC) exempt from auditor attestation requirement under 404(b)

[3] Additional rules apply for SPAC related transactions that allow for potential exemption in the year of acquisition

Certifying officers should not sign the Section 404 opinion, inclusive of the acquired entity, unless they are satisfied the available evidence enables them to do so.

Outgrowing SOX 404(a)

Public companies typically begin their Sarbanes-Oxley (SOX) compliance journey under Section 404(a), which requires only management's assessment of internal controls over financial reporting. However, as companies mature and exit Emerging Growth Company (EGC) status, they become subject to the more rigorous requirements of SOX 404(b), which mandates an external auditor's attestation of management's internal controls.

To maintain EGC status, a company must have less than $1.235 billion in annual gross revenue in its most recent fiscal year and not meet any of the following conditions:

- Annual gross revenue exceeds $1.235 billion.
- Five years have passed since the company's initial public offering (IPO).
- The company has issued more than $1 billion in non-convertible debt over the past three years.
- The company qualifies as a large accelerated filer with a public float of over $700 million.

Transitioning to SOX 404(b) can be challenging. It introduces new complexities, including increased scrutiny from external auditors, higher expectations for documentation and testing, and greater risk of financial reporting errors. Without early preparation, companies may face audit delays, increased costs, and potential damage to stakeholder confidence.

SOX Application to EGC under the JOBS Act/Timeline (for illustration purposes)

	1st 10K	2nd 10K	3rd 10K	4th 10K	5th 10K	6th 10K 404 (b) Compliance	
★ IPO	▼	▼	▼	▼	▼	▼	
Q4 2027	Q1 2028	Q1 2029	Q1 2030	Q1 2031	Q1 2032	Q1 2033	Q1 2034

SOX 302/906 – Quarterly Certifications

CEO and CEO quarterly certifications applicable - required on 1st 10Q filing

SOX 404(a) – Management Attestation

Management's assessment requirements for internal controls over financial reporting – required on 2nd 10K filing (consider if SPAC has already filed 1st 10K)

SOX 404(b) – Auditor Attestation

EGC exempt from auditor attestation requirements for internal controls over financial reporting

This requirement will be delayed until the company no longer qualifies as an EGC (i.e., no later than the 6th year)

SOX 103(a)(3) – Auditor Rotation

Mandatory audit firm rotation shall not apply to an audit of an EGC

Developing a proactive and strategic approach to controls readiness is essential for companies aspiring to go public. Contact Connor Group and start your controls evolution to ensure a smooth transition and enduring success in the public market.

About Connor Group

Connor Group is built for breakthroughs.

We're a professional services firm focused on the most critical opportunities and challenges facing ambitious companies. We're leaders in accounting, compliance, M&A, IPOs, and digital solutions, including strategy, selection, implementation, automation, analytics, and AI. Serving the offices of the CFO, CIO/CTO, and CHRO, we're trusted by over 2,000 of the most exciting brands on earth to deliver results that last.

Founded in 2006, Connor Group quickly became the leading IPO advisory firm. Helping over 250 companies go public built our pragmatic, delivery-oriented approach and $3.3 trillion in client valuation. It also created elite-level pattern recognition and listening skills to identify problems quickly and solve them efficiently.

The majority of Connor Group has industry experience. We know how to get things done. Our expert teams are fluent in function, technology, and world-class communication. Unlike others, we're independently owned and fully in control of how we deliver.

We never compromise on quality. Neither should you.

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