

# **FINANCIAL REPORTING AND ACCOUNTING POLICIES**

**Effective Date: January 15, 2024**

WHEREAS, Nexus Industrial Intelligence, Inc., a Delaware corporation (hereinafter referred to as the "Company"), has established these Financial Reporting and Accounting Policies to ensure compliance with applicable accounting standards and regulatory requirements;

WHEREAS, the Company develops and delivers proprietary artificial intelligence software solutions and requires specialized accounting treatments for its technology development and revenue recognition;

NOW, THEREFORE, the Company hereby adopts the following Financial Reporting and Accounting Policies:

## **1.0 FINANCIAL REPORTING STANDARDS AND PROCEDURES**

### **1.1 GAAP Compliance**

The Company shall prepare all financial statements and reports in accordance with Generally Accepted Accounting Principles ("GAAP") as established by the Financial Accounting Standards Board ("FASB"). All accounting policies, procedures, and financial reporting shall conform to the most current GAAP standards, including but not limited to ASC 606 (Revenue from Contracts with Customers) and ASC 350-40 (Internal-Use Software).

(a) Quarterly Review Requirements: (i) The Company shall conduct quarterly reviews of accounting policies to ensure continued GAAP compliance (ii) Any identified deviations shall be documented and corrected within 30 days (iii) Material changes in accounting policies shall be disclosed in financial statements

(b) Documentation Standards: (i) All accounting policies shall be documented in the Company's Accounting Policy Manual (ii) Policy updates shall be tracked with version control and approval history (iii) Supporting documentation shall be maintained for seven years

### **1.2 Revenue Recognition Methodology**

(a) The Company shall recognize revenue in accordance with ASC 606 using the following five-step model: (i) Identify the contract with a customer (ii) Identify performance obligations (iii) Determine transaction price (iv) Allocate transaction price (v) Recognize revenue upon satisfaction of performance obligations

(b) Performance obligations shall be identified at contract inception and may include: (i) Software license rights (ii) Implementation services (iii) Training and support services (iv) Maintenance and updates

(c) Contract Modification Procedures: (i) Material modifications shall be evaluated as separate contracts (ii) Price adjustments shall be allocated based on standalone selling prices (iii) Modification impact on performance obligations shall be documented

### **1.3 SaaS Accounting Policies**

(a) Subscription revenues shall be recognized ratably over the contract term, beginning on the date that the service is made available to the customer.

(b) Setup fees shall be evaluated for distinct performance obligations and recognized accordingly: (i) When representing a distinct service: Upon completion of setup (ii) When not distinct: Ratably over the subscription term

(c) Multi-element Arrangements: (i) Separate performance obligations shall be identified (ii) Transaction price allocation based on relative standalone selling prices (iii) Regular review of pricing assumptions and methodologies

(d) Contract Asset and Liability Recognition: (i) Unbilled receivables shall be recorded as contract assets (ii) Advance payments shall be recorded as contract liabilities (iii) Regular monitoring of contract asset recoverability

### **1.4 AI Development Cost Capitalization**

(a) Development costs for artificial intelligence models shall be capitalized when meeting all of the following criteria: (i) Technical feasibility has been established (ii) Management has committed to completing the project (iii) Resources are available for completion (iv) The ability to use or sell the asset exists (v) Future economic benefits are probable

(b) Capitalization Guidelines: (i) Direct labor costs for development activities (ii) Third-party development costs (iii) Testing and validation expenses (iv) Data acquisition costs for training models

(c) Amortization Requirements: (i) Capitalized costs shall be amortized over the estimated useful life (ii) Regular review of amortization periods and methods (iii) Impairment testing at least annually

### **1.5 Internal Control Requirements**

(a) Financial Reporting Controls: (i) Segregation of duties for revenue recognition (ii) Regular reconciliation of accounts (iii) Management review of significant estimates (iv) Documentation of key judgments and assumptions

(b) Technology Controls: (i) Access controls for financial systems (ii) Change management procedures (iii) Data backup and recovery protocols (iv) Regular system audits

### **1.6 Disclosure Requirements**

(a) Financial Statement Disclosures: (i) Significant accounting policies (ii) Revenue recognition methods (iii) Capitalization criteria and procedures (iv) Contract assets and liabilities

(b) Supplementary Disclosures: (i) Disaggregated revenue information (ii) Performance obligation details (iii) Significant judgments in applying accounting policies (iv) Changes in accounting estimates

## **2.0 INTERNAL CONTROLS AND RISK MANAGEMENT**

### **2.1 SOX Compliance Framework**

(a) The Company shall maintain a comprehensive system of internal controls in accordance with Sarbanes-Oxley Act Section 404 requirements, including: (i) Control environment assessment, encompassing organizational structure, management philosophy, and ethical values (ii) Risk assessment procedures, with quarterly evaluations of operational, financial, and technological risks (iii) Control activities documentation, including detailed process flows and control matrices (iv) Information and communication protocols for both vertical and horizontal reporting (v) Monitoring activities with independent testing and validation

(b) The Company shall establish a dedicated SOX compliance team responsible for: (i) Quarterly control testing and documentation (ii) Annual certification of internal controls (iii) Remediation of identified deficiencies within 60 days (iv) Regular reporting to the Audit Committee

### **2.2 AI Algorithm Validation Controls**

(a) The Company shall implement and maintain controls for: (i) Algorithm testing and validation, including: - Pre-deployment testing in isolated environments - Performance benchmarking against established metrics - Bias detection and mitigation procedures - Documentation of test results and approvals (ii) Model performance monitoring through: - Real-time performance dashboards - Automated anomaly detection - Monthly performance reviews (iii) Data quality assurance, incorporating: - Input data validation protocols - Data cleansing procedures - Regular data accuracy audits (iv) Version control and deployment procedures, including: - Change management documentation - Rollback capabilities - Emergency patch protocols

## **2.3 Data Security Protocols**

(a) The Company shall maintain comprehensive data security measures including: (i) Encryption of sensitive data through: - AES-256 encryption for data at rest - TLS 1.3 for data in transit - Key management procedures (ii) Access controls and authentication, requiring: - Multi-factor authentication - Role-based access control - Quarterly access reviews - Privileged account monitoring (iii) Audit logging and monitoring, comprising: - System-wide activity logging - Real-time security alerts - Monthly security reviews (iv) Incident response procedures, including: - 24/7 security monitoring - Defined escalation paths - Customer notification protocols - Post-incident analysis requirements

## **2.4 Financial Risk Assessment**

(a) Regular risk assessments shall be conducted to identify, evaluate, and mitigate financial risks related to: (i) Technology obsolescence, including: - Quarterly technology stack reviews - Competitive analysis - Migration planning (ii) Cybersecurity threats, through: - Monthly vulnerability assessments - Penetration testing - Third-party security audits (iii) Customer concentration, requiring: - Customer portfolio analysis - Revenue diversification strategies - Customer satisfaction monitoring (iv) Regulatory compliance, encompassing: - Regulatory change monitoring - Compliance gap analysis - Remediation planning

(b) Risk assessment results shall be: (i) Documented in standardized risk registers (ii) Reviewed quarterly by senior management (iii) Reported to the Board of Directors bi-annually (iv) Incorporated into strategic planning processes

(c) The Company shall maintain insurance coverage appropriate to identified risks, with annual review and adjustment of coverage limits and terms.

## **3.0 REVENUE RECOGNITION AND CONTRACT MANAGEMENT**

### **3.1 Subscription Revenue Recognition**

(a) Subscription fees shall be recognized as revenue over time based on: (i) Contract term duration, which shall be clearly specified in the master service agreement (ii) Service availability date, as documented in the service activation notice (iii) Customer acceptance criteria, including any specified testing periods (iv) Usage-based components, measured through automated monitoring systems

(b) Subscription revenue recognition shall commence upon: (i) Completion of implementation services, if required (ii) Customer's written acceptance of the platform (iii) Activation of customer access credentials (iv) Verification of system availability

(c) Deferred revenue treatment shall apply when: (i) Payment is received in advance of service delivery (ii) Performance obligations remain partially unfulfilled (iii) Service activation is pending customer action (iv) Contract terms specify future service periods

### **3.2 Implementation Services Revenue**

(a) Implementation revenue shall be recognized based on: (i) Distinct performance obligation analysis, considering technical dependencies (ii) Percentage of completion method when appropriate, documented through project milestones (iii) Milestone completion assessment, verified by project management documentation (iv) Customer acceptance criteria, as defined in statement of work

(b) Implementation service recognition criteria shall include: (i) Clear definition of project phases and deliverables (ii) Documentation of resource allocation and time tracking (iii) Regular progress reporting and milestone verification (iv) Customer sign-off requirements for each phase

(c) Implementation revenue deferral shall occur when: (i) Services are significantly integrated with subscription services (ii) Milestone acceptance is pending customer review (iii) Project completion extends across reporting periods (iv) Contract terms specify payment retention conditions

### **3.3 Multi-element Arrangements**

(a) For contracts containing multiple performance obligations: (i) Standalone selling prices shall be determined using observable evidence (ii) Transaction price shall be allocated proportionally using relative standalone prices (iii) Revenue recognized as each obligation is satisfied according to specified criteria (iv) Regular review of allocation methodologies shall be conducted

(b) Performance obligation identification shall consider: (i) Distinct nature of goods or services (ii) Integration requirements with other deliverables (iii) Interdependencies affecting standalone functionality (iv) Customer's ability to benefit independently

(c) Price allocation methodology shall include: (i) Historical pricing analysis for similar arrangements (ii) Market comparison data when available (iii) Cost-plus-margin calculations where appropriate (iv) Documentation of allocation rationale

### **3.4 Contract Modifications**

(a) Contract modifications shall be evaluated to determine: (i) Whether they create new performance obligations requiring separate accounting (ii) Impact on transaction price and revenue recognition timing (iii) Recognition methodology adjustments needed for compliance (iv) Effect on existing performance obligations

(b) Modification assessment procedures shall include: (i) Review of change order documentation (ii) Analysis of pricing adjustments (iii) Evaluation of service scope changes (iv) Assessment of performance obligation modifications

### **3.5 Revenue Recognition Documentation**

(a) Required documentation shall include: (i) Detailed revenue recognition schedules (ii) Performance obligation tracking logs (iii) Customer acceptance documentation (iv) Contract modification records

(b) Regular review procedures shall ensure: (i) Compliance with recognition policies (ii) Accurate timing of revenue recognition (iii) Proper allocation of transaction prices (iv) Complete documentation of recognition decisions

### **3.6 Special Considerations**

(a) Enterprise contracts shall require: (i) Detailed analysis of custom terms (ii) Documentation of non-standard provisions (iii) Review of complex pricing structures (iv) Assessment of extended payment terms

(b) AI implementation projects shall include: (i) Specific milestone definitions for AI components (ii) Recognition criteria for machine learning phases (iii) Documentation of acceptance testing requirements (iv) Analysis of ongoing support obligations

### **3.7 Compliance and Review**

(a) Regular compliance reviews shall: (i) Verify adherence to recognition policies (ii) Ensure proper documentation maintenance (iii) Validate allocation methodologies (iv) Confirm appropriate modification treatment

(b) Quarterly assessments shall include: (i) Review of revenue recognition calculations (ii) Validation of deferred revenue balances (iii) Confirmation of milestone completion evidence (iv) Verification of customer acceptance documentation

## **4.0 INTELLECTUAL PROPERTY ACCOUNTING**

### **4.1 R&D Expense Classification**

(a) Research costs shall be expensed as incurred, including: (i) Basic research activities and feasibility studies (ii) Conceptual formulation and design of alternatives (iii) Laboratory testing and prototype development (iv) Pre-commercial experimental activities (b) Development costs shall be capitalized when meeting criteria in Section 1.4, subject to: (i) Technical feasibility documentation requirements (ii) Commercial viability assessment (iii) Quarterly review of capitalization status (iv) Regular impairment testing protocols

## **4.2 Patent Capitalization**

(a) Legal costs for patent applications shall be capitalized when: (i) Patent protection is probable (ii) Economic benefits are likely (iii) Costs are measurable (b) Capitalized patent costs shall include: (i) Filing and prosecution fees (ii) Professional legal services (iii) Translation and documentation expenses (iv) Maintenance and renewal fees (c) Patent portfolio valuation shall be conducted: (i) Annually for carrying value assessment (ii) Upon triggering events indicating impairment (iii) When considering monetization opportunities

## **4.3 Software Development Costs**

(a) Capitalization shall begin when: (i) Preliminary project stage is complete (ii) Management authorization is obtained (iii) Technical feasibility is demonstrated (b) Qualifying costs for capitalization include: (i) Direct labor and contractor expenses (ii) Software development tools and licenses (iii) Testing and quality assurance activities (iv) Documentation and training materials (c) Post-implementation costs shall be expensed unless: (i) Significantly enhancing functionality (ii) Extending useful life materially (iii) Meeting capitalization thresholds

## **4.4 AI Model Development**

(a) Development costs for AI models shall be: (i) Tracked separately by project (ii) Evaluated for impairment quarterly (iii) Amortized over estimated useful life (b) Specific cost categories include: (i) Data acquisition and preparation (ii) Model training and validation (iii) Computing infrastructure allocation (iv) Technical personnel costs (c) Capitalization criteria for AI models: (i) Demonstrable market or internal use value (ii) Technological feasibility validation (iii) Adequate resources for completion (iv) Clear path to deployment (d) Amortization guidelines: (i) Begin upon deployment to production (ii) Use straight-line method unless pattern differs (iii) Review useful life assumptions annually (iv) Consider technological obsolescence factors

## **4.5 Intellectual Property Transfers**

(a) Internal transfers shall be recorded at: (i) Carrying value for wholly-owned entities (ii) Fair market value for joint ventures (iii) Independent valuation for material transactions (b) Documentation requirements include: (i) Transfer pricing studies (ii) Economic benefit analysis (iii) Tax implications assessment (iv) Board approval for material transfers