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SEC Reemphasizes Its Continued Focus on the New Revenue Standard, Including Advancing ICFR

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In a speech at the 13th Annual Life Sciences Accounting & Reporting Congress on March 21, 2017, SEC Chief Accountant Wesley Bricker reminded registrants of the importance of implementing the FASB's new revenue standard[1] in a timely manner and of providing the transition disclosures required by SEC Staff Accounting Bulletin (SAB) Topic 11.M (SAB 74)[2] before adoption. Mr. Bricker also stressed the key role of internal control over financial reporting (ICFR) in the standard's successful implementation.

Implementation Observations, Interpretive Activities, and Transition Disclosures

Mr. Bricker acknowledged the important step forward the new standard represents in financial reporting, reiterating that revenue is "one of the single most important measures used by investors in assessing a company's performance and prospects . . . . Companies cannot afford to get the accounting wrong — it deserves close attention by preparers, audit committees and auditors."

[1] FASB Accounting Standard Update No. 2014-09, *Revenue From Contracts With Customers*, as amended.
[2] SEC Staff Accounting Bulletin Topic 11.M, "Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period" (SAB 74).

Implementation Observations

As part of discussing the importance of timely implementation of the new standard, Mr. Bricker noted that he is encouraged by the number of public companies that have proactively disclosed the status of their adoption planning and the impact the standard will have on their financial statements. However, he also acknowledged that some public companies need to make "significant progress" this year in their implementation efforts. He encouraged those companies' preparers, audit committees, and auditors to "discuss the reasons why [implementation is lagging] and provide informative disclosures to investors about the status [of their efforts] so that investors can assess the implications of the information."

Interpretive Activities

Mr. Bricker discussed the nature of certain requests received by the staff in the SEC's Office of the Chief Accountant for consultation regarding the standard's implementation. He indicated that a common topic is whether a registrant is acting in the capacity of a principal or an agent in a revenue transaction. Mr. Bricker noted that "[w]hile presentation is just one aspect of the new revenue standard, it highlights several key themes as we think about implementation." Those themes are summarized as follows:

1. *"[A] company must support its presentation . . . according to the core principles in the standard"* — Since investors must be able to understand the nature of the revenue transaction, a registrant will need to use judgment in determining the appropriate manner of presentation. "Often, this judgment will require a careful evaluation of the detailed information regarding the nature, design, and economic substance of the arrangement."
2. *"[T]he guidance has changed"* — The new revenue standard replaces the current risks-and-rewards-based model with a control-focused model. Mr. Bricker observed that certain registrants seem to believe that the presentation of revenue will not change under the new standard. He emphasized that "[w]hile registrants may determine that — as a result of applying the new guidance — the presentation of revenue is the same as under today's revenue guidance, the evaluation will need to be based on the new standard, which has new concepts."
3. *Companies may need to exercise more judgment under the new standard than they do currently, which may result in changes to ICFR* — Mr. Bricker stressed the "necessity of preparers fully understanding the underlying transaction . . . and then faithfully applying the standard" while also cautioning companies "against any overreliance on benchmarking to their peers' accounting policies."
4. *Companies should provide useful disclosures to investors about the impact of adopting the new standard* — Mr. Bricker stated that the "disclosures required by the new standard are designed to allow an investor to understand the revenue arrangement and the registrant's role in it." Preparers need to identify the pertinent facts and related judgments that must be disclosed under the new revenue standard.

Transition Disclosures

Mr. Bricker highlighted the importance of transition disclosures required under SAB 74, especially the need for preparers to provide sufficient qualitative and quantitative disclosures as the standard's adoption date draws closer. In discussing SAB 74 disclosures, Mr. Bricker observed the following:

> [S]ome companies indicate that the impact of the new revenue standard is not expected to be material. The changes in the new standard will impact all companies. Even if the extent of change for a particular company is slight, the related disclosures to describe revenue streams may not be. The scope of the new standard addresses not only amounts and timing of revenue but also new, comprehensive disclosures about contracts with customers, including the significant judgments the registrant has made when applying the guidance.

Mr. Bricker noted the tendency of preparers to deem immaterial — from a recognition, measurement, and presentation perspective — the impact of adopting the new standard. However, such preparers may not yet have assessed the standard's new, comprehensive disclosure requirements. He stated that SAB 74 disclosures should "reflect consideration of the full scope of the new standard, which covers recognition, measurement, presentation, **and disclosure** for revenue transactions" (emphasis added).

Accordingly, as the standard's adoption date approaches, registrants' transition disclosures should demonstrate an understanding of the qualitative and quantitative impact of the new standard, including its enhanced disclosure requirements.

Advancing ICFR

As noted in Deloitte's September 22, 2016, *Financial Reporting Alert*, the SEC staff has emphasized on multiple occasions the need for preparers to focus on ICFR in connection with implementation activities. Mr. Bricker reiterated that emphasis, reminding preparers of the importance of updating and maintaining internal controls as they implement the new standard.

Lessons Learned Over Time

Mr. Bricker indicated that the following "lessons have been learned over time" and that preparers should consider them with the aim of "providing high-quality financial information that investors can rely on":

- Under the new revenue standard, companies may need to make changes to relevant business processes and the control activities within them as well as to refresh other components of ICFR, including professional competence. Mr. Bricker referred to the control environment component of COSO's internal framework,[3] which includes a principle that emphasizes the importance of being able to attract, develop, and retain competent individuals. He noted that "[a]ll companies must have appropriate resources to evaluate revenue arrangements and properly apply the principles of the new standard" and that "having resources with sufficient training and competence is fundamental to the effectiveness of a company's overall control environment."
- The control environment component of COSO's internal framework also includes a separate principle related to commitment to integrity and ethical values, or setting the appropriate "tone at the top." Mr. Bricker remarked that "[a]ppropriate tone at the top is the foundation for the consistent application of the sound judgments required by the new standard. Management should consider whether the existing controls support the formation and enforcement of sound judgments or whether changes are necessary."
- Companies are encouraged to "consider any changes they may make to their established business practices as they transition to the new standard." Potential areas of change could include processes for preparing required disclosures (including gathering, analyzing and sharing necessary information with relevant parties) and information systems that support the financial reporting process.
- The "effectiveness of any changes to internal controls are predicated on a comprehensive and timely assessment of risks that may arise as a result of applying the standard. Such risks may exist at various levels and in different areas of a company and their appropriate identification and assessment may require involvement of management and employees from both the accounting and financial reporting function and other functional areas of a company."

[3] COSO is the Committee of Sponsoring Organizations of the Treadway Commission. In May 2013, COSO updated its *Internal Control — Integrated Framework*, which was originally issued in 1992.

Recent Experience With Disclosures

To illustrate the cost associated with ineffective ICFR, Mr. Bricker cited academic research suggesting companies that disclose internal control deficiencies have higher credit spreads on loans (relative to companies without internal control deficiencies) and those that disclose a control deficiency for the first time "experience a significant increase in cost of equity."

Mr. Bricker also referred to research indicating that companies that remediate internal control deficiencies experience "improved financial reporting quality, reduced cost of capital, and improved operating performance." With the goals of advancing ICFR and avoiding potential increased costs of capital that result from control deficiencies, companies should be proactive in (1) designing and implementing effective internal controls that are specific to the implementation of the new revenue standard and (2) identifying changes to their business processes and activities that are relevant to revenue.