COMPLIANCE WEEK

Agenda 2017: revenue recognition, meet internal controls

In 2017, monumental accounting change in the form of revenue recognition will crash head on with continued intensity around internal controls. **Tammy Whitehouse** reports.

Accounting and audit leaders can expect 2017 to be the year when monumental accounting change crashes head on with continued intensity around internal controls, and it could be an ugly collision for companies that are not adequately prepared.

In terms of accounting change priorities, companies can expect revenue recognition to easily win the top position on their to-do list in 2017. The change is so pervasive, in fact, it should probably occupy the second and third positions on those task lists as well.

The Financial Accounting Standards Board adopted the new requirements in 2014 and deferred the effective date to 2018 to give companies more time to prepare. Yet indicators in late 2016 suggest few companies have reached the point where they even understand how they will be affected by the sweeping new approach to recognizing revenue, let alone taking steps to implement the new requirements.

"There is a tendency for people to underestimate the amount of work," says Eric Knachel, a senior consultation partner at Deloitte & Touche. "The runway is getting shorter, and resources will get tighter and tighter." Couple the impending implementation of revenue recognition with the ongoing intensity around internal control reporting and auditing, and the implications for folks responsible for Sarbanes-Oxley compliance become staggering.

The Public Company Accounting Oversight Board and the Securities and Exchange Commission have continued to signal in 2016 they are not yet satisfied with the level of compliance around internal control reporting and auditing. At a recent year-end accounting conference, regulators indicated they expect audit committees to continue detailed, intense dialogue with external auditors to understand where there are weaknesses in controls that still require correction.

That suggests auditors will bring a laser sharp focus to the internal controls companies will need to develop to implement the new revenue accounting—and many companies haven't even yet determined what that new accounting will look like in their organizations.

"The Sarbanes-Oxley folks are stressed out," says Marie Kish, a partner at EY. "Some didn't realize how much of a change this is in several aspects of the standard, even if there's not much change in the measurement of revenue." The new standard requires companies to follow a new, five-step method for recognizing revenue, overturning the apple cart on existing revenue recognition processes and procedures.

From a controls perspective, companies will need to establish robust controls in a few key areas, says Kish. They need controls over the implementation process, over the new accounting itself, and over the disclosures that will be required leading up to implementation. The SEC has been vocal throughout 2016 that it expects both quantitative and qualitative disclosures to explain to investors the changes that are in store.

Controls over the implementation will be necessary to assure companies have captured all of their contracts with customers and properly considered how they will be affected by the new accounting. Jill Klindt, vice president and chief accounting officer at public company Workiva, says she's expecting auditors to look for proof of how the company reviewed and considered the new standard.

"We have to support that this was a thorough review and we're not just making it up," says Klindt. She's expecting to produce plenty of memos explaining how individual contracts were reviewed and addressed under the new standard, she said.

Even where companies expect the new accounting will not produce significant change to the amounts and timing of revenue recognition, change in the process for arriving at those numbers could be significant, says Bill Tomazin, national audit market development leader at KPMG. "All companies will have some change, some more significant than others, depending on their revenue streams," he says. Changes to the control environment will depend on the nature of the business, the judgments that need to be made under the new standard, the IT systems that need to be in place, and numerous other factors.

Companies that remain stuck in assessing how they will be affected by the new standard are giving themselves less and less time to design and test the necessary controls, says Tomazin. "We've really been trying to coach companies to come out of the 10-K filing season out of their assessments and into design, ready to make some progress," he says. "There is an absolute sense of urgency that we come out of the winter season in full stride with respect to the design and adoption phase."

Gerald Ratigan, senior vice president and chief account-

SEC CHIEF ACCOUNTANT ON INTERNAL CONTROLS

Below is an excerpt from a speech by SEC Chief Accountant Wes Bricker in 2016.

> Well-designed controls support the process by which accounting judgments and estimates are made and the resulting quality of the financial reporting. Our capital markets expect that companies present reliable and complete financial data for investment and policy decision making. Central to this expectation is that public companies maintain reliable and trustworthy accounting records that are supported by appropriate internal controls.
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> ICFR remains a high priority for the OCA staff, and we continue to work closely with our colleagues in the Divisions of Corporation Finance and Enforcement to help ensure that ICFR matters are appropriately addressed.

Source: SEC

ing officer for smaller reporting company MoneyOnMobile, says he sees most companies in the "eye of the storm," with the winds kicking up considerably once companies recognize the enormity of change that might be necessary to their controls.

"Are there proper controls in place to make sure the company is performing an adequate risk assessment?" asks Ratigan. "Have they updated the risk matrix? What are they pointing to [in order] to show they have an appropriate level of controls? That's the discussion I don't see happening."

Knachel says that many organizations appear to be caught in a kind of "catch 22." Many haven't completed their assessments of how they will be affected by the standard to have asked the necessary technical accounting questions, which must be addressed before moving into control design.

"Once you have processes in place, then you can design your controls, but you can't simply jump to designing and testing controls," Knachel at Deloitte says. "It would be like asking someone to give you an answer before you've given them a question. As companies get into the implementation process, that's where the questions surface, and the answer will come, but they don't come until you get into implementation."

Klindt at Workiva says that the organization has established a timeline for how the company plans to move through the end of 2017 to assure a healthy adoption one year from now. "We have a great team, but it will be a stretch," Klindt says, adding. "We feel like we are moving down the right path. Just having a plan makes you feel better about it." ■

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> Eric Knachel, Senior Consultation Partner, Deloitte & Touche

UNDERSTANDING THE NEW REVENUE RECOGNITION STANDARD

Below are five steps from the Center for Audit Quality to help firms understand the core principle of the new revenue standard.

1. Identify the contracts with a customer
An agreement is a contract when approved, identifies rights of the parties and payment terms, has commercial substance, and is probable of collection.

2. Identify the separate performance obligations in the contract
"Performance obligation" is a new term under the standard and judgment is required to identify all the unique performance obligations of a contract. What is the obligation of the vendor under the contract? What benefits (in the form of goods or services) does the customer receive? Is there more than one performance obligation?

3. Determine the transaction price
A significant judgment in this step involves variable consideration, such as contracts that include bonuses, incentives, rebates, and penalties. These amounts will have to be estimated in determining the transaction price.

4. Allocate the transaction price to the performance obligations in the contract
This step is required when there are multiple performance obligations. The allocation process is another area of judgment. The entity should determine the standalone selling price at contract inception of each performance obligation.

5. Recognize revenue when (or as) the entity satisfies a performance obligation
A performance obligation is satisfied when the customer obtains control of the good or service (at a point in time or over time). Control is defined as the ability to direct the use of, and obtain substantially all of the remaining benefits from, the good or service.

Source: Center for Audit Quality