COMPLIANCE WEEK
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Auditors prepare to inspect revenue recognition adoption

In the churn for new auditors, one Big 4 firm has held steady with its net number of audit clients while three others have seen net losses numbering in the 20s. **Tammy Whitehouse** has the results of the latest data from Audit Analytics.

With year-end audits winding down, public companies should be forewarned that auditors are entrenching and developing their game plans for how to scrutinize the impending switch to new revenue recognition accounting.

The 2017 year-end audit cycle will still consist of companies mostly following current revenue recognition rules, with only a handful adopting early. As companies move through their implementation, auditors plan to take a hard gaze over management's shoulder to study how they are preparing for the new accounting and how they will explain it to investors.

All public companies will be required to follow the massive change to new revenue recognition accounting requirements beginning in 2018, and companies are widely expected by regulators and auditors to follow a robust process for making that change to their accounting processes, even if the change won't produce a material effect on financial metrics. The latest poll, this one from KPMG taken in early December, suggests the vast majority of companies are still stuck in the assessment phase, trying to figure out how they are affected and what they need to do to comply with the new requirements.

"Companies are behind," says Betsy Meter, an audit partner at KPMG. "It is starting to pick up in the first quarter, which is a good sign, but it's going to condense a lot of work that needs to get done in the next 10 months." That's leading to concerns about resource constraints. "There's a significant amount of work auditors need to do to not only understand the adoption of the standard but also controls. Even if companies do not expect the impact to be significant, there's still a methodical, well-thought-out assessment process that needs to be done around the new model."

The audit profession is training and developing tools now that will help them with their own transition to performing audits of the new accounting, experts says. BDO USA, for example, is developing tools like checklists, questionnaires, and a workbook that can be used across the global network for companies adopting either under GAAP or international standards, says Bryan Martin, a national assurance partner at the firm. The tools will assist auditors in performing risk assessments and analyzing revenue streams.

Auditors have been engaged from the beginning, when the Financial Accounting Standards Board issued the new requirements in 2014 and even before, studying the standard and considering how it will be applied to different sectors or fact patterns, says Glenn Richards, a senior manager at Crowe Horwath. Now those who have become specialists in certain aspects are leading internal efforts to train others. "Those are your people who are writing the new audit program set-ups that the firms are going to apply when it is rolled out firm-wide," he says.

All of that activity is preparing auditors to ask plenty of

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questions, as 2017 progresses, about how companies are going through their own preparation for the new accounting. "Questions are starting to come in from the practice, and that's encouraging," says Martin. "As we come out of the 10-K filing season, discussions will only pick up in pace."

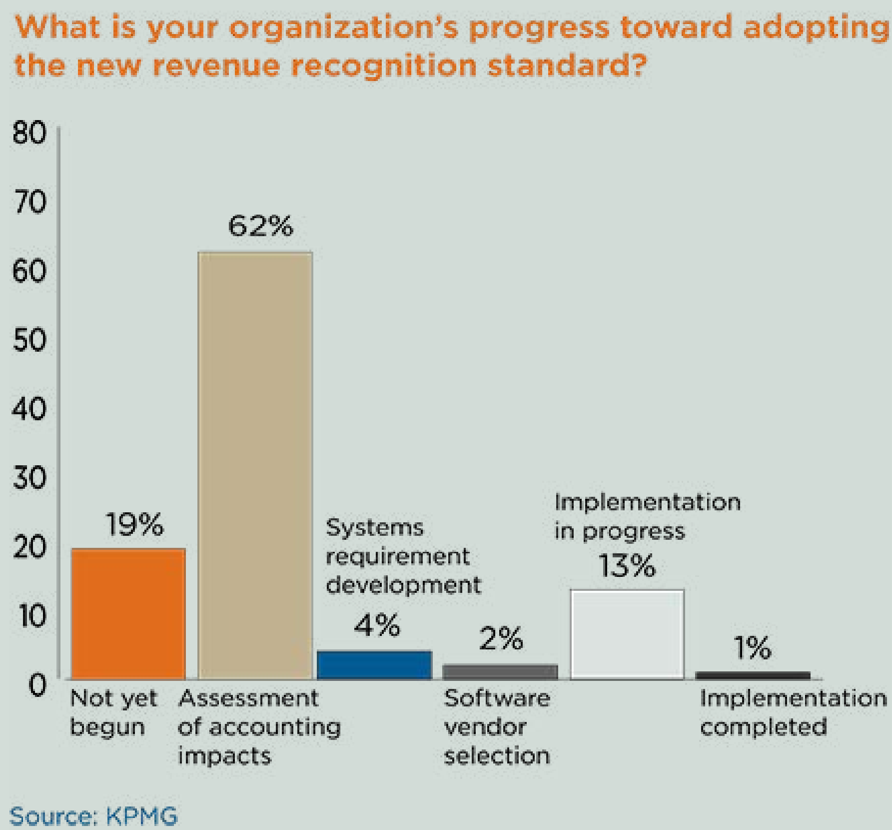
Amy Steele, audit partner in the national office at Deloitte & Touche, says auditors are developing "deep technical expertise" in the new accounting, even within industry sectors where the accounting changes may be more industry-specific, so they will be prepared to ask the right questions as companies proceed through implementation.

Auditors are seeking meetings with management to understand not only the financial statement impact of the new standard, but also to assess the implementation effort and the tone, says Steele. "We need to understand that management has taken this seriously and has allocated sufficient resources and skill sets," she says. "Auditors are asking probing questions."

Where those questions lead to raised eyebrows, auditors will adhere to standards that guide their communications with audit committees, says Steele. "If we have concerns regarding management's application of the accounting, we have to get out in front of the audit committee and have those discussions early," she says. "That's why we as a firm are stressing to our practitioners to have those conversations early in the process to understand the implementation effort."

Sara Lord, national director of assurance services at audit firm RSM, says companies should be prepared to work closely with auditors as they move through adoption this year. "Don't wait until the end," she says. "Just like management's learning in this phase, we are too."

REVENUE ADOPTION



Given how heavily the new accounting relies on management estimates and judgments, auditors will need plenty of evidence and documentation to get comfortable with the new accounting. "As auditors, we need to be able to go in and understand those estimation points along the way," she says. "We don't want to get to the end and have a discussion about something that happened at the beginning that changes the entire pathway of the accounting."

Bert Fox, a partner at Grant Thornton, says auditors plan to spend plenty of time this year studying what management has done to prepare. "How much change will they have from existing standards?" he asks. "How much time and effort have they put into the implementation process? Did they hire a third-party expert? Or are they doing it on a bare-bones budget?"

Fox says he sees some constraints already in the marketplace for people who can provide companies with assistance. "For companies that haven't engaged someone and are going to need to, they're going to find it limited, and prices have gone up," he says.

In a worst-case scenario, if a given company really has not done enough to be ready for the new accounting, auditors could find themselves unable to complete an audit, says Fox. "I do think a lot of companies have taken a cursory view of the new standard," he says. "It could get to a point where we could say we can't do this audit, or we talk to them about starting to declare they have material weakness in internal control. We could also get to a point where a client will not be able to file timely."

Steele says the key takeaway for companies is to keep auditors in the loop. "Take auditors along for the journey," she says. "Talk to auditors now about the evidence you expect to be able to provide to them and allow auditors to ask probing questions." ■