

# Revenue Recognition: ICFR Considerations

**FERF/Workiva**

January 11, 2017

# AGENDA

- CPE Guidelines
- Today's Panelists
- Significance of ICFR related to the new revenue standard
- Discussion & your questions

# CPE Guidelines

- Today's webcast – 1 CPE credit
- Answer 3/4 polling questions
- Participate for 50 minutes
- Download certificate after webcast closes
  - Certification widget in lower right corner

## Today's Panelists



- Randy Staggers, Partner  
Baker Tilly Virchow Krause, LLP



- Joe Howell, Cofounder & EVP,  
Workiva

# ICFR for Revenue Recognition

- Companies largely focused on accounting issues
- ICFR not yet in focus for many
- This webinar will address ICFR... not accounting issues
- Good news

## Companies Are Behind

“The latest poll on the implementation effort around the seismic shift in revenue recognition accounting shows less than one-fifth of public companies have launched adoption activities after making their way through assessments of how they will be affected by the new standard. Three-fourths of companies said they were still assessing, and a handful indicated they hadn’t yet started any assessment or adoption efforts..”

Compliance Week, December 13, 2016

# KPMG: Status of Implementation

KPMG conducted a survey of public and non-public companies in June 2016 to assess their progress in addressing the new revenue recognition standard

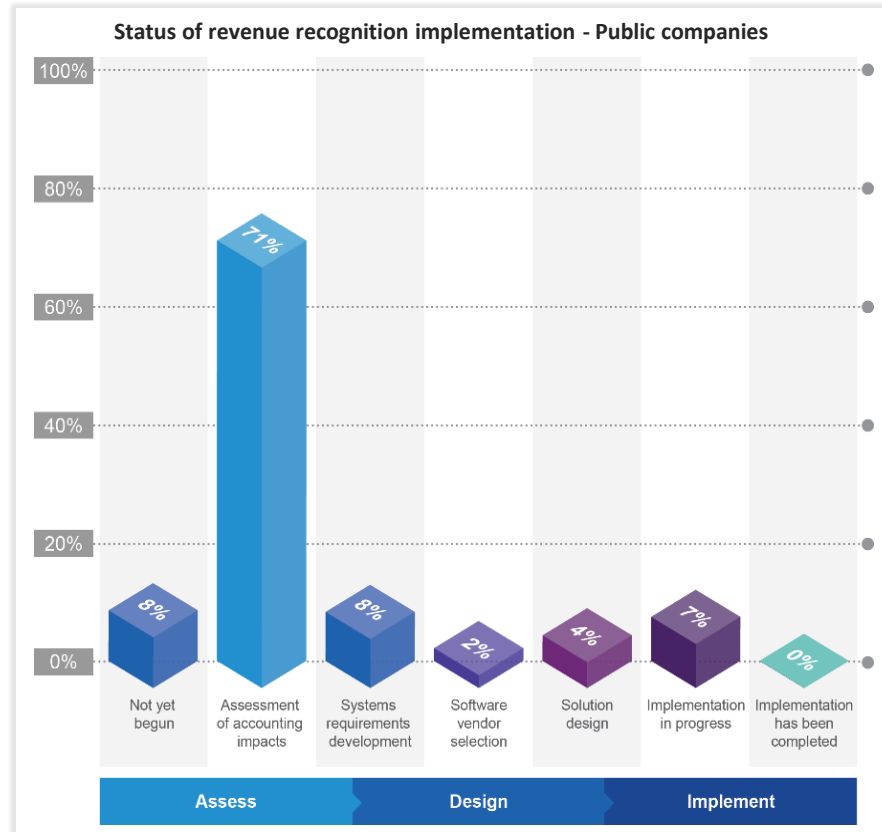
Companies appear “stuck” in assessment

60% believe they are behind

Audit committees expect companies to have a clear plan

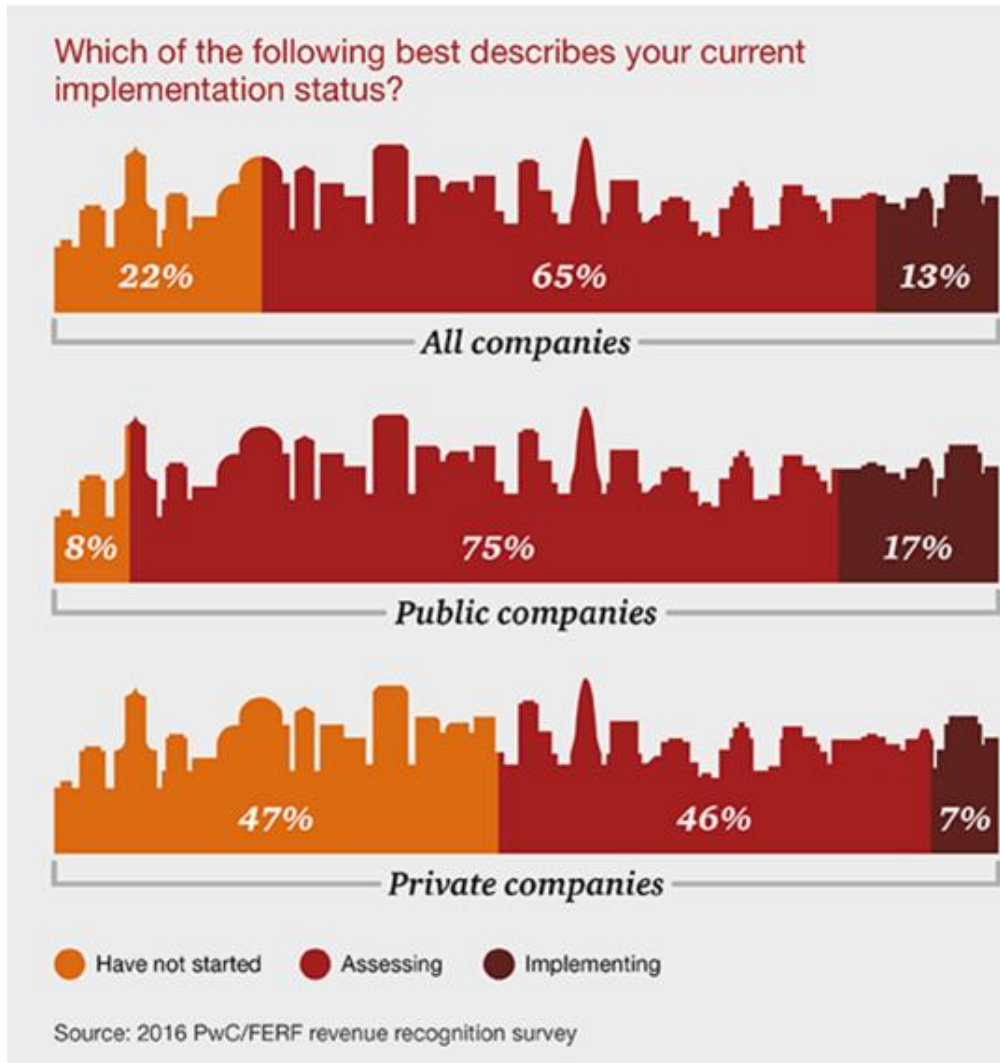
**Other key findings**

Do not underestimate the effort. It will likely take 2-3 months to fully assess impacts and longer to design and implement a go-forward solution



Source: KPMG June 2016 survey

# PwC: Status of Implementation





# Auditors & Regulators Alarmed

“Now regulators and accounting profession leaders are growing alarmed that companies are not making progress at an adequate pace. Experts say even companies that expect to see little change in the numbers after applying the new methods face significant change in their accounting processes and procedures to arrive at those numbers, not to mention significant new disclosures.”

Compliance Week, December 13, 2016

## SEC Focused on ICFR

“...management’s ability to successfully transition to the new standard will depend, to a large degree, on the effective design and operation of internal control over financial reporting (ICFR). Therefore, it is appropriate that ICFR remains an important topic of discussion for management, auditors and audit committees.”

James Schnurr, SEC Chief Accountant  
March 22, 2016

# 2016 Disclosures

“The preparation of the transition disclosures should be subject to effective ICFR and disclosure controls and procedures.”

Wesley R. Bricker, SEC Deputy Chief Accountant  
June 9, 2016

# Regulators Not Backing Off

“With the year-end audit cycle rapidly approaching, regulators are sending signals that their expectations around internal control over financial reporting are not diminishing.”

Compliance Week, November 29, 2016

## PCAOB: Risk Focus

“The board will continue to focus on some of the more troubling areas of internal control audit work, especially auditors’ response to their own assessments of the risk of misstatement... I see it as a way to get to the heart of some of the lingering ICFR problems we have...”

Helen Munter, PCAOB Board Member

# SEC: Risk & Management Judgment

“...the implementation of the new revenue standard provides an opportunity to be proactive and improve the design and operation of management review controls that may exist within a company’s revenue recognition process, including with reference to the various estimates and judgments that the new revenue standard may require.”

James Schnurr, SEC Chief Accountant  
March 22, 2016

# AICPA: Risk & Management Judgment

“Because FASB ASC 606 provides a principles-based accounting model, more judgment will likely be involved in processing routine transactions. Therefore, entities may need to continually reassess the impact of the required financial reporting competencies and revise training, retention, and recruitment appropriately.”

AICPA Audit Risk Alert, Revenue Recognition: Accounting and Auditing Considerations—2016/17

# Risk Assessment

- AICPA Audit Risk Alert – Revenue Recognition: Accounting and Auditing Considerations 2016/2017
  - “For many entities, FASB ASC 606 may pose risks of fairly presenting current and historical revenue. Entities are expected to update risk assessments as a result of considering the effect of FASB ASC 606 on an entity’s ICFR and financial reporting objectives”(.289)
  - “...it is likely that the change in revenue recognition accounting will create new financial reporting risks that the entity may identify and subsequently design controls to address”(.289)
  - “For auditors, revenue recognition is a presumed fraud risk” (.290)

***Think about what could go wrong and the impact at each stage of the process.***



# Control Objectives— Examples

- Identify the contract with the customer
  - Does the contract(s) meet the criteria of 606?
  - Have you properly considered evaluating as individual or combined contracts?
  - As changes occur, how will the organization reassess the criteria?
  - How will you ensure payment terms and collectability are properly considered?

# Control Objectives- Examples

- Performance obligations
  - How will you monitor that you identified explicit and implicit obligations?
  - Did your process/judgment accurately identify if this is a series or single obligation?
- Transaction Price
  - Was your transaction price accurately estimated including variable (constrained) considerations?
  - Is there a significant financing component?
  - Are their non-cash considerations and did you value them accurately?

# Control Objectives— Examples

- Allocate the transaction price
  - How are you comfortable the price was properly allocated?
    - Variable considerations and discounts
    - Stand-alone selling price estimation
- Satisfaction of performance obligations
  - How have you monitored when they are satisfied?
  - Are you accurately measuring progress?
  - How are you comfortable that control has been transferred to the customer?

## PCAOB Copy & Paste

“The Firm failed to test whether the control operated at a level of precision that would prevent or detect material misstatements, as it failed to ascertain and evaluate the nature of the review procedures performed, the criteria used to identify items for follow up, and how those items were resolved.”

PCAOB inspection reports

PwC & Deloitte, August 2016

KPMG, October 2015

Ernst & Young, June 2015

# Document, Document, Document

“Management is responsible for maintaining evidential matter, including documentation, to provide reasonable support for its assessment. This evidence will also allow a third party, such as the company’s external auditor, to consider the work performed by management.”

SEC: Regarding Management’s Report on Internal Control Over Financial Reporting, June of 2006

# Is ICFR Worth The Added Expense?

One-third of the public companies who responded to the survey said compliance with Section 404 of Sarbanes-Oxley has improved their internal controls and has been worth the added expense.

FERF 2016 Audit Fee Survey

# Reduced Audit Fees

Companies with effective controls see lower increases in audit costs than those that have ineffective controls

- 19.5% of public companies reported internal control problems in 2015, audit fees increased a median 5.1%
- Public companies not reporting problems with controls the audit fee cost increase was a median 3.1%

FERF 2016 Audit Fee Survey

## Don't Waste Time

“I am supportive of the attention to ICFR in the high-risk areas that are regularly the source of restatements. But I see a lot of time spent in low-risk areas such as payroll that does not make sense from a cost-benefit perspective. The low risk areas already get sufficient attention in the substantive audit.”

Bob Conway, former PCAOB inspect staff



# Linkage

- Risk assessments: What matters, what doesn't
- Controls in context of relevant risks
- Document key judgments and MRCs

# Q&A

# Closing Comments

# DRAFT Seed Questions for Q&A

- We are still waiting for final procedures... what do you recommend to get a head start?
- What are companies doing to improve documentation of management judgments & MRCs?
- If the new standard has only a minor impact on our financial statements, can the ICFR issues still have a big impact on us?
- What can companies do to reduce the cost of controls related to management judgment?