ASC 606 Transition: The role of ICFR and Auditor Expectations

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As a Managing Consultant at RGP, Dave works as a part of RGP’s National Accounting Team in support of its advisory services. He has extensive US GAAP expertise and is currently focused on revenue recognition and leasing efforts. Prior to joining RGP in 2015, Dave spent 9 years with United Services Automobile Association (USAA) as the Assistant Vice President of Accounting Policy and External Reporting, 3 years with GE Insurance as the Lead Technical Accounting Advisor, 5 years at the National Association of Insurance Commissioners as the Statutory Accounting Principles Manager and 6 years as an audit manager at Deloitte & Touche.
ICFR for Revenue Recognition

- Companies largely focused on implementation and technical aspects of ASC 606
- ICFR just coming into view for many
- This presentation focuses on ICFR – NOT technical accounting issues

Which of the following best describes your current implementation status?

All companies:
- 22% Have not started
- 65% Assessing
- 13% Implementing

Public companies:
- 8% Have not started
- 75% Assessing
- 17% Implementing

Private companies:
- 47% Have not started
- 46% Assessing
- 7% Implementing

Please rate the expected impact of the new revenue recognition standard on the following areas.

- Accounting policies/procedures: 78% Moderate to high impact, 65% Low impact, 62% Unsure
- Internal control environment: 26% Moderate to high impact, 65% Low impact, 54% Unsure
- Business processes/policies: 33% Moderate to high impact, 33% Low impact, 54% Unsure
- IT systems: 16% Moderate to high impact, 26% Low impact, 33% Unsure

Source: 2016 PwC/FERP revenue recognition survey
In a speech at the 2016 AICPA National Conference on Banks & Savings Institutions on September 21, 2016, SEC Interim Chief Accountant Wesley R. Bricker remarked that as registrants develop plans for the transition ASC 606, they should assess the adequacy of their current internal controls “to reasonably assure the reliability of the financial information reported by management.”
COSO Framework & ASC 606

Let's examine the impact of ASC 606 on the 5 COSO components and 17 Principles.

Control Environment
1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

Risk Assessment
6. Specifies relevant objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

Control Activities
10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

Information & Communication
13. Uses relevant information
14. Communicates internally
15. Communicates externally

Monitoring Activities
16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies
Does management, including the board, understand the new standard and the impacts it may have on the ENTIRE organization?

<table>
<thead>
<tr>
<th>Control Environment Considerations</th>
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</thead>
<tbody>
<tr>
<td>Management and the board have obtained an understanding of the new standard</td>
</tr>
<tr>
<td>Internal audit has been informed of the upcoming changes and is involved with the change process</td>
</tr>
<tr>
<td>Adequate personnel resources have been allocated to the process</td>
</tr>
<tr>
<td>• Personnel have received training and understand the entity’s revenue streams</td>
</tr>
<tr>
<td>• Cross functional teams have been organized</td>
</tr>
<tr>
<td>Change management processes are in place</td>
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</tbody>
</table>
The organization will need to fully understand and weigh the risks adoption of the new accounting standard will pose.

**Risk Assessment Considerations**

<table>
<thead>
<tr>
<th>Consideration</th>
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<tbody>
<tr>
<td>The entity has undertaken an assessment of the risks associated with the adoption</td>
</tr>
<tr>
<td>Understands how an entity’s unique revenue streams may be impacted by the standard</td>
</tr>
<tr>
<td>Considered the transition method and the risks related to that choice</td>
</tr>
<tr>
<td>Understands the risks associated with dual accounting records for a period of time</td>
</tr>
<tr>
<td>Adequately considered the controls to deploy for transition accounting</td>
</tr>
<tr>
<td>Considered the need for new or revised controls to address the five steps of revenue recognition</td>
</tr>
<tr>
<td>Considered the need for new or revised controls to adequately address the enhanced disclosure requirements</td>
</tr>
</tbody>
</table>
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

**Identifying the Contract**

- Supporting contract recognition for oral agreements
- Determining collectability
- Evaluating whether contracts should be combined
- Assessing specific accounting for contract changes
- For contracts not recognized; reassessment processes
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

Step 1 – Identify the contract
Step 2 – Identify performance obligations
Step 3 – Determine transaction price
Step 4 – Allocate transaction price
Step 5 – Recognize revenue

**Identifying Performance Obligations**

Deterring the promises in a contract

Explicit as well as implicit promises

Determining whether a performance obligation is distinct in the context of the contract

Assessing warranties, implied, explicit, extended
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

### Determine Transaction Price

<table>
<thead>
<tr>
<th>Support for estimating variable consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applying the probability weighted approach or the most likely outcome approach</td>
</tr>
<tr>
<td>How was the probability of constraint on variable consideration determined</td>
</tr>
<tr>
<td>Assessing the fair value of non-cash consideration</td>
</tr>
<tr>
<td>Issues related to finance component for long term contracts</td>
</tr>
<tr>
<td>Periodic reassessment of variable consideration</td>
</tr>
</tbody>
</table>
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

**Allocate the Transaction Price**

- Supporting standalone selling prices
- Applying discounts
- Applying changes to allocation when estimated variable consideration changes
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

**Step 1 – Identify the contract**

**Step 2 – Identify performance obligations**

**Step 3 – Determine transaction price**

**Step 4 – Allocate transaction price**

**Step 5 – Recognize revenue**

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**Recognize Revenue**

- Determining whether to recognize at a point in time or over time
- For over time recognition, supporting the criteria for passage of control
- Recognition pattern
- Determination of control
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

**Disclosure Considerations**

Controls over disclosure information not in accounting records:
- Uncompleted contracts
- Changes in contracts: cumulative catch up adjustments

Qualitative disclosures
- Significant estimates and judgments: variable consideration; financing element; applying the constraint and releasing the constraint; how discounts were applied; how refund obligations were determined, etc.
New control activities will be required addressing the five steps and the related estimates and judgments ... more documentation needed to support estimates.

**Step 1 – Identify the contract**

**Step 2 – Identify performance obligations**

**Step 3 – Determine transaction price**

**Step 4 – Allocate transaction price**

**Step 5 – Recognize revenue**

**Transition Considerations**

Process for dual accounting records during the transition period(s)

Support for applying any practical expedients

SEC issuers have current period disclosures required under SAB 74 (SAB Topic 11.M); non-SEC issuers should also consider engaging stakeholders to communicate transition plans and potential effects on the financial statements
The information needs of ASC 606 and the transition are extensive. Companies will need to gather information that previously did not need to be documented as part of the accounting process and may not exist in easy to access or consistent locations.

### Information and Communication Considerations

- Will likely need to be gathered from across the organization: contracts, implied promises, side deals, etc.
- Assessing completeness and accuracy of such data will be critical.
Monitoring activity is likely to be increased, both on an ongoing basis and as it relates to the transition process. The internal audit function, management and board are likely to have roles in the monitoring function. Organizations should prepare to incorporate this activity across these functions.
### Panel F: Type of misstatements identified by the SEC in the AAERs

<table>
<thead>
<tr>
<th>Type of misstatement</th>
<th>Percent of 874 firms misstatement events (1)</th>
<th>Percent of 581 firms misstatement events with at least one quarterly misstatement and stock price data (2)</th>
<th>Percent of 624 firms misstatement events with at least one annual misstatement (3)</th>
<th>Percent of 519 firms misstatement events with at least one annual misstatement and total assets data (4)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Misstated revenue</td>
<td>51.14%</td>
<td>56.28%</td>
<td>55.61%</td>
<td>57.03%</td>
</tr>
<tr>
<td>Misstatement of other expense/ shareholder equity account</td>
<td>33.30%</td>
<td>35.28%</td>
<td>35.90%</td>
<td>36.61%</td>
</tr>
<tr>
<td>Capitalized costs as assets</td>
<td>25.86%</td>
<td>21.17%</td>
<td>22.60%</td>
<td>22.16%</td>
</tr>
<tr>
<td>Misstated accounts receivable</td>
<td>20.14%</td>
<td>22.03%</td>
<td>22.92%</td>
<td>23.12%</td>
</tr>
<tr>
<td>Misstated inventory</td>
<td>13.62%</td>
<td>16.01%</td>
<td>16.19%</td>
<td>16.57%</td>
</tr>
<tr>
<td>Misstated cost of goods sold</td>
<td>10.41%</td>
<td>12.74%</td>
<td>12.34%</td>
<td>12.72%</td>
</tr>
<tr>
<td>Misstated liabilities</td>
<td>8.24%</td>
<td>8.95%</td>
<td>9.29%</td>
<td>9.44%</td>
</tr>
<tr>
<td>Misstated reserve account</td>
<td>9.15%</td>
<td>9.12%</td>
<td>9.46%</td>
<td>9.44%</td>
</tr>
<tr>
<td>Misstated allowance for bad debt</td>
<td>3.43%</td>
<td>3.27%</td>
<td>3.85%</td>
<td>3.47%</td>
</tr>
<tr>
<td>Misstated marketable securities</td>
<td>3.66%</td>
<td>2.58%</td>
<td>3.69%</td>
<td>2.70%</td>
</tr>
<tr>
<td>Misstated payables</td>
<td>2.17%</td>
<td>2.75%</td>
<td>2.88%</td>
<td>3.28%</td>
</tr>
</tbody>
</table>

**Note:**
There are a total of 1,583 misstatements mentioned in column 1, 916 misstatements in column 2, 1,215 misstatements in column 3, and 1,020 misstatements in column 4, so percentages sum to more than 100 percent.

Questions