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Control changes with ASC 606 implementation

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ASC 606 early adopters identify changes to financial reporting controls. KPMG highlights what those changes are.

Applicability

ASC 606, ASC 340-40, and all recently issued ASUs for these topics:

— All companies

Form 10-Q control disclosures

Reviews of Item 4, Controls and Procedures, of Form 10-Q, show that nearly 40 percent of companies that early adopted ASC 606 included discussion that their controls had changed as a result of implementing the new standard. Have you thought about what to disclose in your upcoming 10-Q about controls related to adoption and implementation of the new revenue standard? Here are two examples.

"Beginning January 1, 2017, we implemented ASC 606, Revenue from Contracts with Customers. Although the new revenue standard is expected to have an immaterial impact on our ongoing net income, we did implement changes to our processes related to revenue recognition and the control activities within them. These included the development of new policies based on the five-step model provided in the new revenue standard, new training, ongoing contract review requirements, and gathering of information provided for disclosures."

Ford Motor Company Item 4 excerpt from Form 10-Q for the quarter ended March 31, 2017

"Effective January 1, 2017 we adopted Accounting Standards Codification 606, Revenue from Contracts with Customers. Changes were made to the relevant business processes and the related control activities, including information systems, in order to monitor and maintain appropriate controls over financial reporting. There were no other changes in our internal control over financial reporting during the quarter ended March 31, 2017, which were identified in connection with management's evaluation required by paragraph (d) of Rules 13a-15 and 15d-15 under the Exchange Act, that have materially affected or are reasonably likely to materially affect our internal control over financial reporting."

Power Integrations, Inc. Item 4 excerpt from Form 10-Q for the quarter ended March 31, 2017

These examples remind us that management has a responsibility to maintain effective controls and to disclose in the interim 10-Q filings any material changes to internal controls over financial reporting (ICFR). However, it does not appear that all early adopters limited their disclosures to material changes.

ASC 606 is so significant that some companies discussed the adoption of the standard and its effect on processes and controls even if management didn't believe the adoption or implementation rose to the level of a material change in their controls. This approach is reflected in the following example.

"We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standards related to revenue recognition and leases on our financial statements to facilitate their adoption on July 1, 2017. There were no significant changes to our internal control over financial reporting due to the adoption of the new standards."

Microsoft Corporation Item 4 excerpt from Form 10-Q for the quarter ended September 30, 2017

Think about adoption in two parts

When considering Item 4 disclosures, it may be helpful to think about adoption of the standard in two parts: 'one-time' controls that were put in place to adopt and transition to the new standard; and 'ongoing' controls that are more permanent changes that need to be made to account for current and future transactions under ASC 606.

Even if material changes to controls were not needed for ongoing transactions, there are likely some significant changes for the one-time controls necessary to adopt and transition to the new standard.

Don't forget entity-level controls

Further, when evaluating whether Item 4 should include language to disclose control changes, a company should also consider the effect on its entity-level controls that underpin the effective adoption of ASC 606, as well as new controls or changes to existing controls to capture the disclosures.

Controls not only need to be designed and operating to record transactions properly, but also to ensure that implementation and adoption are effective and to comply with the new disclosure requirements.

Good governance

Finally, while the risk assessment, design and implementation of ICFR is required by SEC Rules and Regulations, robust controls that are responsive to the new accounting standard are good, healthy governance. And disclosing information about those controls or changes to existing controls provides investors with a more comprehensive understanding of the effect of a company's adoption of ASC 606.

In a speech last December, Wesley Bricker, the SEC's Chief Accountant, said,
"…over the next several years, internal controls will be particularly important as companies work through the ***implementation of the significant new accounting standards (****emphasis added). Well-run public companies have effective internal controls not just because internal controls are a first line of defense against preventing or detecting material errors or fraud in financial reporting, but also because strong internal controls are good for business and can have an impact on costs of capital."*

He went on to say,
"If left unidentified or unaddressed, internal control deficiencies can lead to lower-quality financial reporting which can ultimately lead to higher financial reporting restatement rates and higher cost of capital."—SEC Speech, Statement in Connection with the 2017 AICPA Conference on Current SEC and PCAOB Developments

More resources

Handbook	Assists you in gaining an in-depth understanding of the new five-step revenue model by answering the questions that we are encountering in practice, providing examples to explain key concepts and highlighting the changes from legacy US GAAP. In particular, section 16.7.30 discusses internal control considerations for transition.
KPMG Executive View	ASC 606 implementation – don't forget internal controls and disclosures – discusses considerations associated with internal controls over financial reporting when adopting the new revenue standard. It includes specific views on control areas to be sure to evaluate.
ICFR reference guide	Guide to understanding and assessing ICFR, including the 2013 COSO framework and deficiency evaluation.

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