2016 FEI-CFRI:
SUMMARY

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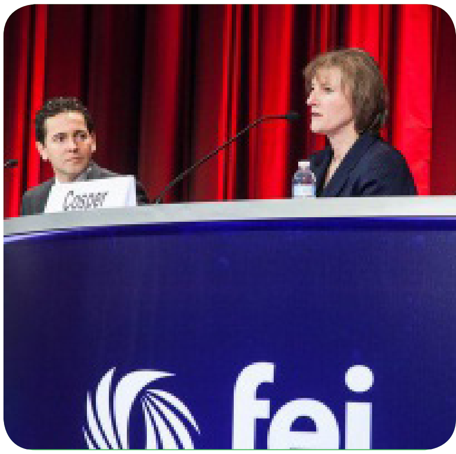

Financial Executives International (FEI) held its 35th annual **Current Financial Reporting Issues** (CFRI) conference in New York City on November 14 and 15.

The CFRI conference focuses on the issues currently faced by financial statement preparers. Representatives from the Financial Accounting Standards Board (FASB) and SEC discussed emerging accounting trends, concerns, and guidance. Panelists included SEC registrants, regulators, public accounting firms, and attorneys.

The following highlights were prepared by one of Siegfried's Professionals, and focus on the conference's most compelling sessions.

- Implementation of the Revenue Recognition Accounting Standard
- The New Leases Accounting Standard
- Non-GAAP Measures and Metrics: Getting it Right

Implementation of the Revenue Recognition Accounting Standard

The following FEI panel discussed ASU 2014-09, Revenue from Contracts with Customers (Topic 606):

- Christine DiFabio, Assistant Controller, Zoetis Inc.
- Michael Cleary, Vice President, Accounting and Financial Reporting, The Boeing Company
- Kevin McBride, Global Accounting and Financial Services Controller, Intel
- Steve Rivera, Worldwide Senior Director, Financial Compliance and Procedures Group, Johnson and Johnson

This new standard will impact all companies within certain industries more affected than others. Companies that buy or sell bundled products and services (multi-element) or engage in major projects could see significant changes in the timing of revenue recognition. Upon adoption of the new standard, companies will be required to follow a five-step process to recognize revenue. The five steps are:

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognize revenue when (or as) the entity satisfies a performance obligation

During the assessment phase, companies may establish their planned method of adoption: a full retrospective method or a modified retrospective method. The full retrospective method requires that the cumulative effect of adoption on periods prior to those presented shall be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented. Meanwhile, the modified retrospective method requires companies to apply the new revenue standard only to the financial statements in the year of adoption.

A PwC survey indicates that a full 52% of respondents do not have a planned method of adoption, 18% have selected full retrospective, and 30% have selected the modified retrospective method.

52% do not have a planned method of adoption

18% have selected full retrospective

30% have selected modified retrospective

Implementation Status

The panel referenced PwC's recently published survey, 2016 Revenue Recognition Survey: Readiness Update, Impacts, and Remaining Challenges[1], which provides information on the implementation progress, challenges, and impacts of implementation and resources needed. This survey found that 75% of public company respondents are continuing their initial impact assessment and that only 8% of public company respondents have not begun an assessment.

More than 75% of all respondents cited contract reviews, new accounting policies, and documentation of the conversion process as the most difficult aspects of implementing the new revenue recognition standard. This shows that substantial progress has been made since the standard was introduced.

[1] http://www.pwc.com/us/en/audit-assurance-services/accounting-advisory/assets/2016-PwC-FERF-rev-rec-survey.pdf

For public business entities, as well as certain nonprofit entities and employee benefit plans, the effective date is annual reporting periods, and interim periods therein, beginning after December 15, 2017. The effective date for all other entities is one year later (December 15, 2018). Early adoption is permitted only as of annual reporting periods, and interim periods therein, beginning after December 15, 2016.

FASB/IASB Joint Transition Resource Group for Revenue Recognition

On June 3, 2014, the FASB and the IASB announced the formation of the Joint Transition Resource Group for Revenue Recognition (TRG). The TRG will inform the IASB and the FASB about potential implementation issues that could occur when companies or organizations implement the new standard. The TRG will also provide stakeholders with an opportunity to learn about the new standard from others involved with implementation. While the TRG does not specifically issue guidance, they inform the FASB and IASB about implementation issues. Recently published standards related to issues identified by the TRG include:

- ASU 2016-12: Narrow-Scope Improvements and Practical Expedients
- ASU 2016-10: Identifying Performance Obligations and Licensing
- ASU 2016-08: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)

Staff Accounting Bulletin Topic 11.M (SAB 74) Disclosure Requirements

On September 22, 2016, the SEC staff issued comments on the disclosure requirements of SAB 74 related to the expected impact on financial statements of the future adoption ASU 2014-09. SAB 74 requires disclosure of the potential material effects of newly issued standards when they are adopted. In addition to the general statement about the lack of sufficient information or the inability to reasonably estimate the expected impact on the financial statements, the Staff asked registrants to consider additional qualitative disclosures to:

- A brief description of the new standard, the date that adoption is required, and the date that the registrant plans to adopt, if earlier.
- A discussion of the methods of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined.
- A discussion of the impact that adoption of the standard is expected to have on the financial statements of the registrant, unless not known or reasonably estimable. In that case, a statement to that effect may be made.
- Disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the standard (such as technical violations of debt covenant agreements, planned or intended changes in business practices, etc.) is encouraged.

The New Leases Accounting Standard

The following FEI panel discussed implementation of the new leasing standard ASC 842 — Leases:

- Robert Grecco, Senior Vice President and Controller, Ralph Lauren Corporation
- Gregg Nelson, Vice President and Chief Accountant, IBM
- Chad Soares, Partner, PwC
- Brent Woodford, Senior Vice President Planning and Controller, The Walt Disney Company

The panel discussed a number of implementation issues, including the effort to undertake a complete and accurate inventory of leases, use of leasing systems, and key decisions, such as the use of practical expedients. The FASB has not set up a transition resource group as they did for revenue recognition, but the panel discussed the responsiveness of the FASB as well as the Emerging Issues Task Force to questions from constituents.

Lease Identification
ASC 842 provides two criteria to determine whether a contract contains a lease: A lease must explicitly or implicitly identify a specific asset that is the subject of the contract, and the lessee must have the right to control the asset. If the lessor has a substantive substitution right, the contract does not meet the definition of a lease. The substantive right to substitute an asset requires the practical ability to substitute the identified asset and the lessor benefits from that right.

Under ASC 842, a contract conveys the right to control the use of an identified asset if, throughout the period of use, the customer has the right to direct the use of the identified asset and obtain substantially all of the economic benefits from the use of the identified asset.

Lease Inventory and Tracking
The panel discussed a number of implementation issues, but the most significant issue is identifying and tracking all of their company's leases. Often, authorization to enter into lease agreements is allocated throughout the company and lease agreements may not always be communicated for current reporting requirements. The current lease reporting does not involve the same rigor required to implement the new standard.

Additionally, service and other agreements that may contain embedded leases have not always been scrutinized since service agreements and operating leases were off balance sheet. To facilitate the identification and assessment of all lease agreements, companies are assessing the need for specialized software and/or third party assistance.

Practical Expedient Elections
An entity may elect the following practical expedients, which must be elected as a package and applied consistently by an entity to all of its leases (including those for which the entity is a lessee or a lessor), when applying the pending content that links to this paragraph to leases that commenced before the effective date:

1. An entity need not reassess whether any expired or existing contracts are, or contain, leases.

2. An entity need not reassess the lease classification for any expired or existing leases (that is, all existing leases that were classified as operating leases in accordance with Topic 840 will be classified as operating leases, and all existing leases that were classified as capital leases in accordance with Topic 840 will be classified as finance leases).
3. An entity need not reassess initial direct costs for an existing leases.

As discussed in ASC 842-20-25-2, a lessee may elect not to apply the recognition requirements of ASC 842 to short-term leases. This election should be made by class of underlying asset. If a lessee chooses to elect this short-term lease exception, it should recognize the lease payments in net income on a straight-line basis over the lease term. Variable lease payments should be recorded in the period in which the obligation for the payment is incurred.

ASC 842 provides a practical expedient that permits lessees to make an accounting policy election (by class of underlying asset) to account for each separate lease component of a contract and its associated non-lease components as a single lease component. Lessees that do not make an accounting policy election to use this practical expedient are required to allocate the consideration in the contract to the lease and non-lease components on a relative standalone price basis.

Non-GAAP Measures and Metrics: Getting it Right

The conference hosted a session focused specifically on the use of non-GAAP measures. It featured the following panelists:

- Nik Cyprus, Director and Chairman, Audit Committee Digital Globe Inc.
- Mark Kronforst, Chief Accountant, Division of Corporation Finance, SEC
- John White, Partner, Cravath, Swaine & Moore LLP
- Neri Bukspan, Partner, EY
- Mark Lamonte, Managing Director, Moody's Investors Service

In addition to the dedicated panel, nearly every session of the conference discussed the impact of the SEC's focus on non-GAAP measures, including perspectives from Cathy Engelbert, CEO Deloitte LLP and Russell G. Golden, Chairman, Financial Accounting Standards Board. The increased attention by financial statement preparers and auditors in 2016 is the result of the SEC's Division of Corporation Finance (DCF) updating its Compliance & Disclosure Interpretations on the use of non-GAAP financial measures in May 2017[2], as well as increased focus on non-GAAP measures in comment letters issued by the DCF.

Many companies disclose non-GAAP measures as they provide investors information about their business that reflects management's assessment of their company's performance. Non-GAAP measures vary and may provide additional information about operational performance, liquidity, or the ability to comply with covenants in debt agreements. Members of the panel discussed the evolution of non-GAAP measures to address the limitations of GAAP and to provide more relevant information to investors. The FASB has received calls from some constituents to provide standardized non-GAAP measures to increase clarity and minimize confusion.

Percentage of reviews with SEC comment letters

23%	17%
2016	2015

As there is little consistency in what non-GAAP measures individual companies disclose and how similar measures are calculated, the SEC has expressed concern that their use may be misleading or confusing. According to Deloitte's publication, *SEC Comment Letters —Statistics According to "Edgar" — A Supplement to the Ninth Edition*[3], SEC comments related to non-GAAP measures were included in 23% of reviews with comment letters in review year 2016, compared with 17% in the prior year.

In 2016, comments focused on (1) undue prominence of a non-GAAP measure (e.g., by including a full non-GAAP income statement); (2) when a non-GAAP measure is not appropriately reconciled to the most directly comparable GAAP measure; (3) disclosures about the purpose and use of non-GAAP measures and clear labeling; (4) liquidity versus performance measures; and (5) the nature of reconciling adjustments and the related disclosures. Deloitte's statistics noted above do not reflect the comments solely on Forms 8-K, which show the additional emphasis that the SEC staff has been placing on non-GAAP measures.

The panel discussed best-practice approaches to non-GAAP measures such as maintaining consistency within a company's previous SEC filings and within its industries. The panel specifically mentioned a publication from the Center for Audit Quality: *Questions on Non-GAAP Measures – A Tool for Audit Committees*[4] as a useful resource for financial statement preparers and auditors when drafting or reviewing non-GAAP disclosures.

[2]https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm
[3]https://www2.deloitte.com/content/dam/Deloitte/us/Documents/audit/us-aers-sec-comment-letters-statistics-according-to-edgar-supplement-to-the-ninth-edition.pdf
[4]http://www.thecaq.org/docs/default-source/reports-and-publications/questions_on_non-gaap_measures_final.pdf