Revenue Recognition Changes – Technological Impacts

Na'ama Drukman
Jan-2016

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Agenda

New change represents a high risk

Trends and Solution options

Challenges and automation risks

Scope of the Change
Potential areas of difference

Volume discounts	Contingent revenues	"Cash cap" guidance	Service level agreements	Distributor revenues	Allocation of discounts	Extended payment terms
Sales commissions	Funded R&D arrangements	Certain subscriptions	Ratable revenue may change	Time value of money	Consignment arrangements	Bill and hold arrangements
Other contract costs	Term licenses	Customer loyalty programs	Vendor protection clauses	Contract modifications	Extended warranties	In-transit loss coverage
Discounted goods or services	No VSOE limitation	Roadmaps	Implied maintenance	Residual approach	Customization/ implementation	Elimination of software guidance

Disclosures

Transition alternatives

Revenue accounting represents high risk

Revenue Recognition represents the high risk of material error on financial statements. This is because of 2 factors – (1) evolving business model & solution bundling complexity (2) inadequacy of financial infrastructure

Business Model & Solution Bundling Complexity **+** Inadequacy of information infrastructure **=** High Revenue Compliance risk
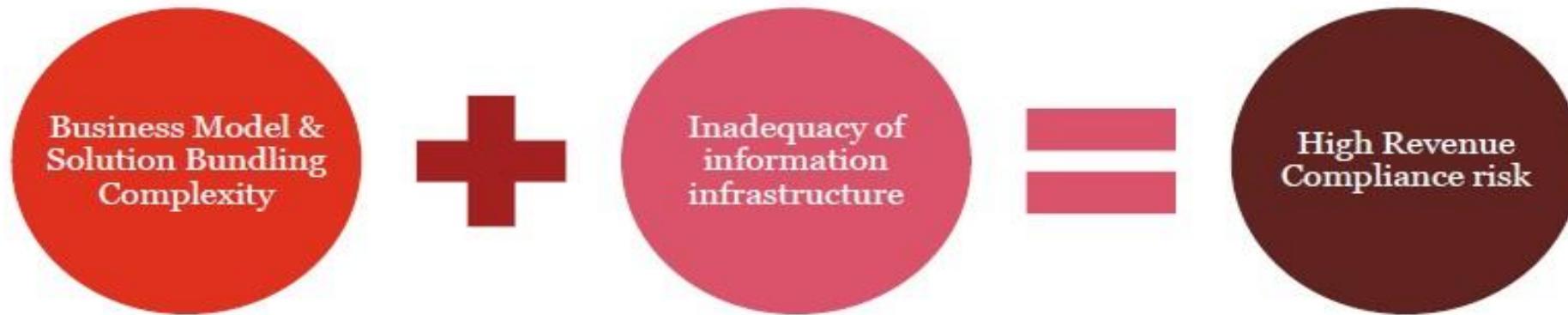
Inadequacy of financial systems to address the revenue automation requirements of evolving business models & solution bundling has led to high compliance risk as well as operational inefficiency within finance/accounting functions.

Effective Date and Adoption Methods

Transformative change is on the horizon

Revenue Recognition Standard Transformation

Current GAAP · FY'2014 · FY'2015 · FY'2016 · FY'2017 · FY'2018 · New Standard

Final Standard Issued · **clarifications** · *Potential* **Dual Reporting Period** · **Effective Date**

Full *Retrospective Approach* — Current GAAP / New Standard

Modified *Retrospective Approach* — Current GAAP / New Standard
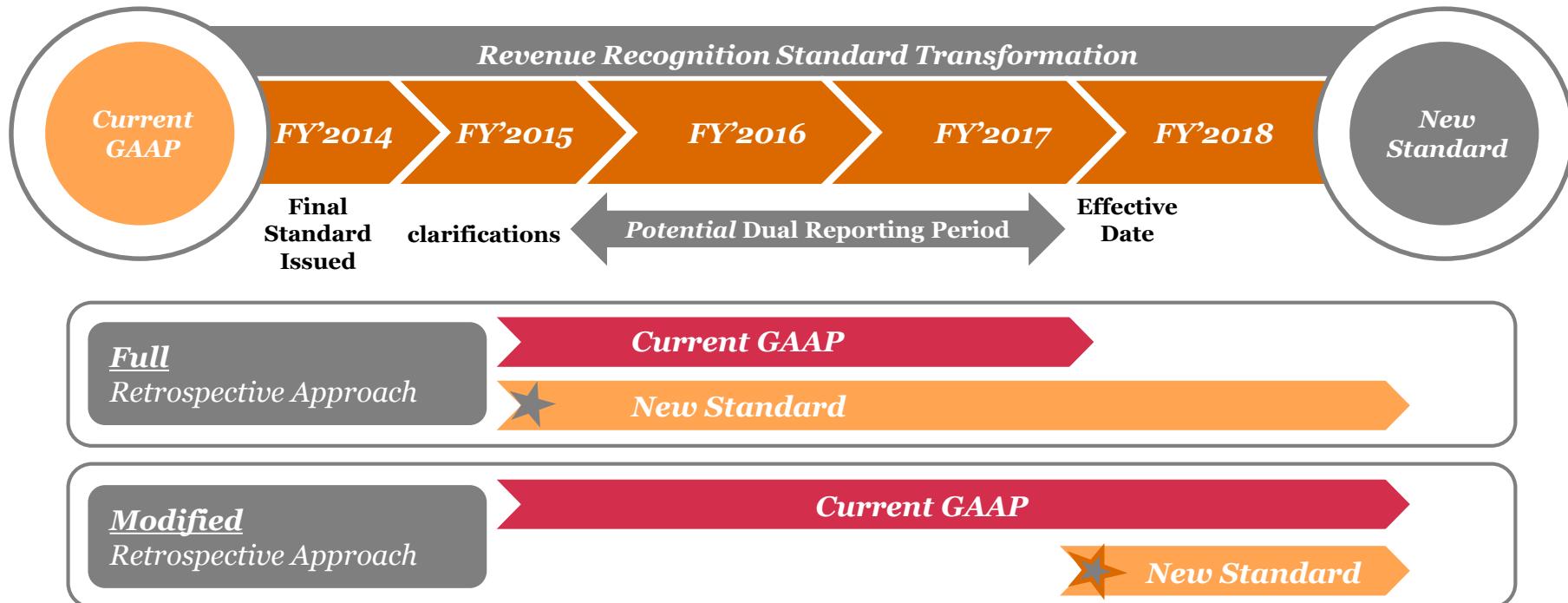
Cumulative adjustment to Retained Earnings will be reported

Current GAAP versus new Standard impacts will be disclosed

Note : The above timeline assumes a calendar year-end

Under the retrospective approach in IFRS- presentation of only the annual period immediately preceding the first annual period for which this Standard is applied is needed

Revenue automation solutions

Revenue automation tools in the market

- ERP Solutions:

    - SAP Revenue Accounting & Reporting

    - Oracle Fusion Revenue Management

    - Netsuite

- Examples of third-party solutions:

    - Leeyo RevPro

    - Microgen/Aptitude Revenue Recognition Engine

    - Revenue Edge

    - RevStream

    - Softrax

Involvement of IT is paramount; the new standard provides an opportunity to implement revenue automation replacing Excel spreadsheets and manual processes

Implementing this change should follow comprehensive SDLC, leveraging the right people, process, technology and data


Effectively managing revenue recognition change

Revenue automation trends in the market

Challenges

- Limited standard out-of-the-box functionality available in ERPs

- Maintenance of complex Access and/or Excel models, customizations of ERPs or manual process

- Complexity and number of systems hosting data relevant for revenue recognition

- It takes time for functionality to catch up with new requirements (i.e. New Revenue Recognition Standard)

What can be automated

Automated

- Straight-forward single element revenue recognition
- Overtime (Ratable) revenue recognition for service/maintenance
- Point in Time - Revenue recognition on an systematic pattern
- Simple cost deferral
- Performance Obligation breakout with bundled SKUs
- Standalone Selling Price calculation and allocation
- Fair Value establishment (i.e. standalone selling price)
- Simple deal/contract deferral (e.g., FOB, partial shipment)
- Linking deals/contracts into multiple elements arrangement
- Complex deal/contract deferrals
- Complex cost deferrals
- Variable considerations
- Deal/contract review

Manual

Effectively managing revenue recognition change

Revenue automation challenges

What can go wrong?

Vendor selection

- 3rd party tools have low market presence

- Insufficient use cases considered or business requirements incomplete when vetting vendors

Automation scoping

- Attempting to automate revenue recognition 100%

- Unable to identify all revenue recognition scenarios upfront when defining system requirements

- Failure to consider fringe cases – non standard revenue scenarios

Implementation and maintenance

- Rules are too rigid to accommodate change in business model, offerings, and/or regulations

- Varying data sources for the same data element creates added complexity

- Revenue team is not involved in NPI to ensure 3rd party tool is updated to manage revenue recognition for new products

Revenue automation system implementation risks

- Proper stakeholders are not identified and/or properly involved in the project

- Business requirements are not clearly defined or incomplete

- Design documentation becomes outdated/incomplete making monitoring implementation progress and future maintenance difficult

- Project is not properly managed to prevent scope creep and/or overruns

- Inadequate testing prior to go-live as a result of factors above or inadequate test data to reflect production scenarios

- Proper oversight is not provided during the project

- Data is not converted completely and accurately to the revenue system

Generally strict observance to a System Development Life Cycle methodology and controls will mitigate the risks above.

Revenue Automation Capabilities for Topic 606

Currently Expected Functionality

- Analysis of historical sales data to determine SSP (stand-alone selling price)
- Link related transactions into single contract
- Break-out of performance obligations
- Booking of contract asset
- Relative allocation method
- Accounting for contract modifications
  - ✓ Add products / services, upgrades, terminations
- Ability to "turn-off" contingent revenue limitation
- Dual reporting
- Reporting based on adjusted revenue
  - ✓ Reporting exists today, but needs to be improved

Functionality Not Yet Included

- Sales Commissions
- Time Value of Money
- Variable Consideration
- Disclosures
- Robust Reporting

Effectively managing revenue recognition change

Revenue Automation Solutions

Benefits

- Functionality that allows for automated allocation of revenue between different revenue regulations (relative vs residual)

- Some have functionality that will help with easier adoption of Topic 606

- In line with technical accounting requirements for Current US GAAP

- Reduces the amount of manual processing and excessive use of spreadsheets

- Used for revenue forecasting, waterfall and other sub-ledger reporting

- Provides real time visibility into revenue / deferred revenue

Challenges

- Dependent on external upstream data feeds (revenue triggers, orders and elements' explosion)

- High volumes of data have not yet been processed in live-production environments.

- One more system in the middle before transactions get to GL and adds another layer of reconciliation

- Relatively small vendor dominative market

- Release of new versions is impacted by the timing of the new revenue standard

- Functionality to address Topic 606 is in the process of being built out and has not been tested or adopted by any clients yet

Effectively managing revenue recognition change

To Conclude

Whatever solution you choose, it should be provide a comprehensive solution that is

Flexible yet Methodical

Rapid yet Systematic

Comprehensive yet manageable

Automated yet Controlled

Thank You

Na'ama Drukman

ERP Solutions Practice Leader

Naama.drukman@il.pwc.com

054-2000443

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