Sage Business Partner

White paper

Mastering the Complexity of Revenue Management

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Accounting simplified.

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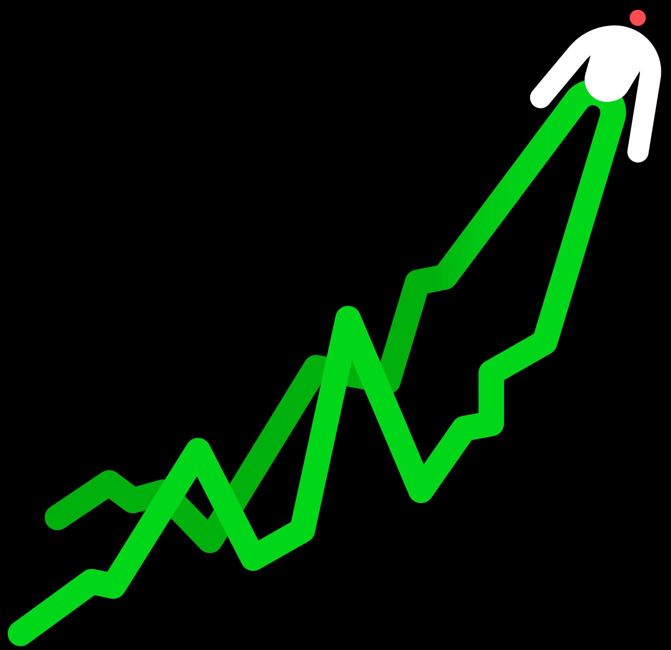

Executive summary

For many finance professionals, revenue management is among the top challenges today. With its combination of loosely defined regulations, evolving standards—such as the new revenue recognition rules under Accounting Standards Codification (ASC) 606, and stiff penalties for noncompliance, revenue management creates unacceptable levels of complexity and variability that often overmatch the resources and expertise of many finance teams. Faced with these hurdles, companies are looking to automate revenue management processes to gain efficiency, strengthen compliance, and improve visibility.

The two-pronged strategy for successfully streamlining revenue management starts with processes designed from the top down, based on input from multiple stakeholders and functions.

The other key is the ability to deploy technology that further streamlines, centralizes, and automates the revenue management process.

Sage Intacct Revenue Management automates and optimizes the financial processes associated with complex revenue recognition. Sage Intacct is the cloud-based technology that allows your finance team to connect systems, automate processes, and analyze the business. This solution frees your staff from the intricacies and headaches of managing revenue with manual processes and complicated spreadsheets, while keeping current with the latest accounting standards and providing greater insight into the health of your business.

Introduction

The complexity of revenue management continues to challenge finance professionals. Only recently, have companies been able to stay competitive by developing and delivering new products and services to meet diverse customer demands. But to keep a competitive edge today, companies must also find innovative ways to generate revenue, which, in turn, leads to a multitude of ways to account for that revenue. Simultaneously, regulatory frameworks are placing greater compliance demands on companies of all sizes and across all industries. As a result, corporate financial professionals must deal with revenue from transactions, subscriptions, and contracts that are dramatically more complicated as they navigate an evolving maze of nuances, rules, and requirements for revenue accounting.

To date, finance has struggled with time-consuming, error-prone spreadsheets to handle these increasingly complicated—and critical—revenue recognition tasks, while gathering data from an ever-increasing variety of sources. At the same time, executives want a better sense of the business by seeing real-time results for the current quarter and accurate revenue forecasts for upcoming quarters. Unfortunately, those outdated methods of spreadsheets and manual data reconciliation are no longer sufficient to handle the greater complexity and scale of contemporary revenue recognition and management-reporting challenges.

Four key complexities of revenue management

1. Regulatory compliance
Guidance from the American Institute of Certified Public Accountants (AICPA), the Securities Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) can make revenue managers feel like they're trying to hit a moving target—blindfolded. These regulations are challenging to interpret and apply consistently, particularly since many companies execute so many non-standard agreements with customers. To add to the complexity, the International Accounting Standards Board (IASB) and FASB have issued a new revenue recognition standard that will replace the current U.S. industry standards for fiscal periods ending on or after December 15th, 2017. Industry leaders have called this new standard the most significant revenue recognition guidance in the last 15 to 20 years.

2. Internal controls
From a financial controls perspective, revenue is an area that financial auditors declare as displaying inherent risk and one that is frequently probed by regulators.[1] As a result, companies should design Internal Controls Over Financial Reporting (ICFR) to mitigate the risk of material error in revenue accounts. One of the primary drivers for risk in the revenue account is the significant management judgement that comes with recognizing revenue, especially with the upcoming revenue standards.

3. Forecast visibility
For many companies, revenue forecasting is more art than science. There is often confusion as to whether sales or finance owns the revenue forecast. Furthermore, since a traditional income statement does not distinguish between one-time and recurring revenue, companies fail to properly manage the impact of deferred revenue and recurring business. This translates into more than just failures of predictability—it also represents tremendous potential for lost opportunities in renewals, upsells, and cross-sells.

4. Staff productivity
Today, too many companies are using simple spreadsheets for critical revenue-accounting tasks. Fragile, static and complex single-user spreadsheets require extraordinary manual effort to build and maintain. Even with all that effort, almost all sophisticated spreadsheets contain errors, which can lead to wasted time spent investigating those errors, and, in the worst cases, material financial reporting errors. Complex revenue recognition spreadsheets are a chief cause of monthly close delays and revenue leakage. What's more, they lack the easy auditability and strong security that are required for such a heavily regulated function.

1. *http://pcaobus.org/News/Releases/Pages/09092014_SAPA12.aspx*

Evolving requirements increase the complexity

In industries like software and professional services, revenue management is one of the most challenging issues for financial executives because of the complexity involved in revenue allocation among elements and the timing of revenue recognition.

Traditionally, software companies have licensed their software for on-premises installation at a customer's location. Annual maintenance fees typically range from 15-20 percent and include free upgrades and technical support. For these software companies—and other organizations that sell bundled offerings—establishing the fair value to allocate each element in a multi-element arrangement (MEA) is a compliance challenge.

Current guidance on how to determine fair value for a MEA–such as VSOE, third-party evidence (TPE), or estimated selling price (ESP)—provide companies with greater clarity and accuracy in the way they recognize revenue where software and services (such as implementation, migration, training, and technical support) are bundled into a single contract. Instead of rolling complex MEA into a single topline figure or treating certain elements in the arrangement as having no value, accounting standards require businesses to allocate the total revenue for the bundle based on the fair value of each element. If fair value cannot be determined, companies can face difficulty in justifying revenue recognition prior to delivery of the entire contract, potentially delaying recognition for months or years, or risking incorrect calculations and timing of all subsequent revenue.[2]

Today, vendors and buyers alike are embracing software as a service (SaaS). This is essentially a month-to-month subscription to use software that the vendor manages in its own data center. Revenue recognition challenges occur when multiple elements and discounting are involved in a SaaS contract, which is quite common. SaaS and subscription-based businesses rely on recurring revenues that can be earned and recognized in a variety of pricing and billing models, which places even greater importance on the accurate allocation, calculation, and forecast of revenue. To forecast and measure the health of their businesses, SaaS companies rely on metrics such as monthly recurring revenue and churn that differ from traditional GAAP metrics. A major challenge in generating these subscription metrics is that traditional finance systems were not designed to track and report on them, leaving finance teams to rely on spread-sheet based reporting processes.

In service-based businesses, such as technology implementation, law and accounting firms, and consultancies, revenue management and recognition are predicated on specific contracts and unique terms. Here, project-delivery milestones, whether contractually agreed upon or based on percentage of completion, are the elements tied to recognizing revenue.

Revenue recognition processes in these organizations require firms to capture all billable time and expenses and to track project statuses to tie events back to contract terms. From a tracking perspective, this introduces challenges in terms of time, complexity, and cost because few companies have integrated systems that connect timesheets with revenue recognition systems. Once again, spreadsheets emerge as the tool of last resort to track this complex, fast-changing, but business-critical data.

2. *Under SOP 97-2 if post-contract customer support (PCS) services are the only undelivered element and there is no VSOE, then the entire bundle of revenue is recognized ratably over the PCS contract period. This is still the case for enterprise software companies, but SaaS companies are guided by EITF 08-01. Under that guidance, you will always get to fair value of the element (VSOE, third-party evidence, or estimated selling price).*

Preparing for the new revenue recognition guidance

In 2014, FASB announced a new accounting standard for Revenue from Contracts with Customers. The new standard provides sweeping changes to existing industry guidance and is widely regarded as the most substantial change to revenue recognition in the last decade. For public companies the effective date of the new standard is reporting periods on or after December 15, 2017 whereas for non-public companies the effective date is one year later.

Due to the material changes to systems and processes required by the new standard it is imperative for companies to create a transition plan now to ensure a smooth transition by the effective date. A best practice implementation plan should exhibit three phases: Planning, Implementation, and Testing.

The main goal in the planning phase will be to investigate the scope of the changes necessary to make the transition. This involves educating yourself on the new standard and reviewing your current policies and procedures as well as systems and processes involved in recognizing revenues.

The next phase will involve implementing changes to systems, policies and procedures. It is important to note that if your company engages in long-term contracts that straddle the effective dates it will also be necessary to start capturing relevant information ahead of the effective date under both the new and the old rules.

The last stage of the project should be analyzing and testing the financial impact of the new revenue recognition rules. For example, the new revenue recognition rules might materially change the timing of recognizing revenue which should be communicated to stakeholders.

Start with a better process

Faced with these hurdles, companies are looking to automate revenue management to achieve better compliance, improve visibility, and lower their costs. Somewhat counter-intuitive, but automating the process doesn't start with technology. Since revenue management touches virtually every area of the organization, streamlining starts with thoughtful processes designed from the top down based on input from senior executives across multiple disciplines and functions.

- Define the revenue recognition foundation. Executives across the organization—finance, sales, product development, customer support, and operations—must play central roles in defining revenue management and revenue recognition policies. Without their involvement, ambiguities can make it more difficult for finance to implement consistent and defensible procedures and rules. Determine in advance:
    - What is a subscription?
    - What falls under "maintenance" or "support"?
    - Will fees be predetermined, based on the number of users, based on usage or transactions, or based on project milestones?
    - What discounts will you permit and how will those discounts be allocated?
- Establish fair value pricing criteria (VSOE, TPE, ESP) using market-tested parameters and centralized data.
- Get auditors involved in these process designs and policy definitions. Their agreement will pay huge dividends during audit time.
- Use standard contracts with defined terms. These contracts must be flexible enough to adapt to your business needs but standardized enough to prevent revenue management variances that create problems down the road. While exceptions and one-offs will always be a factor, standard contracts enable revenue managers to apply rules more consistently and document, track, and defend the exceptions granted to specific customers. Minimize the use of side agreements that only create headaches for long-term revenue management.
- Avoid information conflicts and gaps by enabling your organization to collaborate and share information across sales, services, and finance. In most organizations, these are considered separate functions that are managed with different processes and systems.

The technology for revenue management: key criteria

Automating the management of revenue accounting can yield significant tangible benefits from a variety of perspectives and sources—from faster period closes to greater accuracy and lower costs. To streamline and centralize revenue management, businesses must deploy technology that allows the finance team to connect systems, automate processes, and analyze the business in a timely manner.

1. Connect systems

Streamlining the quote-to-cash process by integrating front- and back-office systems eliminates duplicate data entry between finance and the rest of the business, which saves time and reduces errors. The best accounting systems connect to critical business systems within the organization, such as CRM, services management, and subscription management to create a complete ecosystem for revenue management. In this model, all stakeholders in the company have access to the latest customer data when they need it, in the applications that they use most. This is possible because modern software, especially cloud-based software, is built with open application programming interfaces (APIs) as a central part of its architecture, making it a simple and straightforward task to create integrations among disparate software products.

Customer relationship management

A common revenue management weakness lies in the disconnect between sales and finance. The sales rep manages and completes sales in the CRM system, then sends the agreement over to finance, which is responsible for billing, collections, revenue recognition, and accounting.

Better alignment between sales and finance means the sales team has a better understanding of the impact and timing of revenue, renewals, and upgrades, and that finance is no longer hostage to side-deals and one-off agreements that create unnecessary compliance issues and added manual effort. Since sales and finance have a 360-degree view of each customer, the company benefits from enhanced control of the sales process, improved customer service, and more accurate and timely reporting and forecasting.

Subscription management

Subscription-based businesses use a variety of pricing and billing models, which requires the finance team to manage the accurate billing, subscription changes, and revenue recognition that comes with a recurring revenue business. Incorporating a subscription lifecycle management solution with your accounting and CRM systems lets you eliminate duplicate data entry, save time, reduce errors, and process a higher volume of transactions without adding headcount.

Project management

The lifeblood of a services organization is the ability to accurately and timely capture all project-related time and expenses. Yet reporting on and accounting for this services data is often a patchwork of multiple systems, data silos, and spreadsheets that results in rekeying, manual steps, errors, workarounds, and cumbersome reporting. Furthermore, services revenue is almost always recognized on different schedules than product and subscription revenue.

Strong integration between the project management system and the general ledger streamlines revenue recognition on project milestones, reduces errors, and avoids the “double-vision” of having different project information in two systems. For example, a strong integration enables billing and revenue recognition take place automatically as project milestones are completed. A system that allows you to track services projects within the CRM application offers even greater visibility and automation.

2. Automate processes

Each company's revenue recognition process varies according to its unique business model, products, and markets. To automate this complex process, revenue managers need the ability to codify the applicable rules through flexible templates and schedules that reflect the nuances of their business. The process must drive the automated calculation of both recognized and deferred revenue schedules and forecasts based on contract terms, subscription length, project milestone, and more and integrate with the general ledger. Automation of the revenue recognition process can dramatically cut staff workload, reduce spreadsheet errors, improve accuracy, eliminate cumbersome calculations and reviews that delay closings, and provide a single point of audit and reconciliation.

In addition to automating revenue recognition calculations and compliance, a financial system should also automate other related processes including:

Billing

The best financial systems let you separate billing schedules from revenue recognition schedules. For instance, a company may choose to bill quarterly for a one-year contract, but recognize the revenue on a monthly basis as the service is delivered. This frees the firm up to negotiate billing and payment terms with customers that are decoupled from revenue recognition requirements. By automating the process and reducing inaccuracies, you can ensure that all appropriate revenue is captured through accurate and timely billing, in a form that the customer expects.

Subsequent modifications

These are events that affect your deferred revenue schedule "midstream." For instance, suppose a customer with a standard 12-month contract unexpectedly delays its implementation by two months. You can't simply tack on two months at the end. You must make a subsequent modification that recalculates your revenue schedule to recognize the remaining deferred revenue over the extended period. As the frequency of subsequent modifications grows, they become a nightmare to manually enter, calculate, and audit in a simple spreadsheet. This is one area where automation can deliver enormous benefits in efficiency and accuracy.

Add-ons

Suppose you sell software to 10 users for one year. But six months later, that customer adds five more users for a year—users whose term expires six months later than the original order. The right solution lets you adjust and "co-terminate" so that all users end their current terms at the same time. Flexible, simple add-ons and co-terminations streamline the renewal process for you and your customers, drive additional revenue, increase long-term customer satisfaction, improve accuracy and consistency, and increase efficiency.

Renewals

The best revenue management solutions use reporting tools that automatically forecast upcoming renewals and include scheduled price markups or discounts. With this clearer visibility into contracts and expirations, finance can automatically alert sales reps to proactively cross-sell and upsell customers with additional products and services in a timely and appropriate fashion that reduces customer churn. This automation creates more accurate revenue and cash-flow forecasts from consistent subscription renewals, which increases profitability because it costs less to retain a customer than to find a new one.

3. Analyze the business

Leading revenue management systems provide more than connections and automation. They provide a solid picture of both current and deferred revenue by showing a real-time picture of future revenues, projected renewals, and total deferred revenue stretching months or years into the future. Furthermore, they allow you to analyze the impact that changes to products and pricing can have on revenue, improving your forecast accuracy. The best financial systems let finance teams dig deeper to understand the true dynamics of their business, with visibility into both financial and operating data, and flexibility to view the business through multiple lenses—for example, understanding data and metrics by customer, vendor, employee, product, or project—to make better long-term, strategic decisions.

Case study: SevOne streamlines revenue management with Sage Intacct

SevOne helps hundreds of companies manage the performance of their critical IT infrastructures. In addition to multi-entity and multi-currency management, SevOne also needs to maintain fair value pricing for deferring revenue in multi-element arrangements. Sage Intacct's ability to define specific templates, rules, and schedules helps SevOne define fair value for perpetual licenses and annual maintenance, simplifying its deferred revenue forecasts, and reducing human error.

Sage Intacct for revenue management

Sage Intacct Revenue Management automates and optimizes the financial processes associated with complex contractual relationships. The solution eliminates complicated spreadsheets that inevitably lead to errors, lost revenue, and compliance risks.

With Sage Intacct Revenue Management, you can maximize billing and collections, automate revenue deferral and revenue recognition, and optimize contract renewals. Sage Intacct Revenue Management includes a wide variety of built-in reports to help forecast deferred and recognized revenue and ensure compliance with the SEC, FASB, and Sarbanes-Oxley.

As your business grows and adds complexity, Sage Intacct can meet your needs as you add products and services, increase revenue, acquire or partner, expand internationally, or even go public. Sage Intacct's flexible architecture was built for the cloud and is infinitely scalable and adaptable to meet your needs. Sage Intacct allows your finance team to connect systems, automate processes, and analyze the business to achieve superior revenue management.

- Connect with CRM: Sage Intacct offers a preconfigured cloud connector to Salesforce CRM that ensures the two systems automatically share information. That means both systems are always up to date with product and price lists, customer data, and more. This integration optimizes the revenue recognition process by automatically triggering invoicing and revenue recognition when a sale is completed in Salesforce. Sage Intacct also lets you configure transactional flows to meet unique quoteto-cash process needs that are typically predefined and customized with code in other systems.

- Connect with subscription management: Built on the Salesforce1 Platform, and fully integrated with Sage Intacct financials, Sage Intacct Subscription Billing leverages Sage Intacct revenue management capabilities. Automate billing, subscription changes, and revenue recognition to instantly boost the efficiency of accounting and sales teams. Use flexible pricing and accurate billing to more easily attract new customers and retain current ones.

- Connect with project management: Sage Intacct Project Accounting is fully integrated with Sage Intacct's financials, ensuring all financial data is contained in the financial system of record and providing cohesive, streamlined financial management. Only Sage Intacct connects project accounting to revenue recognition, using timesheets and completed milestones to automatically recognize revenue, while maintaining a separate billing schedule.

- Automate revenue deferral and revenue recognition: Sage Intacct Revenue Management allows you to set up revenue recognition rules for different types of products and services and allows you to post revenue automatically, based on flexible revenue recognition schedules. You can also set up complex fair value allocation rules which give you even greater control over re-allocation and timing of revenue. This automation reduces the errors and revenue leakage associated with manual spreadsheets, and accelerates the closing process by providing accurate, auditable revenue recognition journal entries. Sage Intacct Revenue Management also maintains detailed information about customer contracts within a centralized repository.

- Automate billing: Sage Intacct Revenue Management automatically generates billing schedules from contractual billing rules, leading to accurate, timely, and justifiable bills. The system is unique in that it also consolidates multiple billing types into a single bill and presents bills in multiple custom formats.

- Automate subsequent modifications: Sage Intacct Revenue Management automatically calculates deferred revenue and recognized revenue without tedious manual workarounds so you can control changes as they occur: hold and resume scheduled entries and project milestones, manage subscription upgrades and downgrades, cancel further revenue recognition for an item, or edit the posting date or amount of a transaction.

- Automate add-ons: Sage Intacct Revenue Management allows for flexible subscription and license add-ons and co-terminations that streamline the renewal process for you and your customers.

- Automate renewals: Sage Intacct Revenue Management streamlines the contract renewal process and increases renewal revenue by automatically scheduling, managing, and providing visibility into contract renewals. The system automatically notifies customers or salespeople before renewal dates, reducing the risk of churn.

- Gain visibility into deferred and recognized revenue: Sage Intacct Revenue Management allows you to quickly and easily forecast deferred, recognized, and renewal revenue so you have instant access to reliable, accurate business forecasts.

- Report on subscription metrics: Make quicker, more sound strategic decisions with real-time SaaS metrics that go beyond GAAP metrics to include operational metrics. Captured in an automated process from inside Sage Intacct, they're every bit as complete and accurate as your GAAP financials.

Case study: Evariant deploys Sage Intacct cloud financial management system to improve business operation

Evariant is a SaaS company that brings cloud-based data and analytics to healthcare providers. Evariant migrated its Excel-based revenue recognition models to Sage Intacct, which now powers one unified, automated revenue management process from the time sales orders are first created, through ongoing billing, forecasting and renewals. Today, the finance team provides each department with revenue by customer, which brings greater visibility into the entire organization.

"Sage Intacct delivered flexibility to integrate with our application ecosystem, and timesaving revenue recognition capabilities—such as complete transparency between Salesforce bookings information, as well as revenue activity down to a SKU-level."

James Orsillo, Chief Financial Officer

Conclusion

Mastering the complexity of revenue management starts with thoughtful, top-down processes. Only with those in place should you add technology to automate revenue management. Sage Intacct is the cloud-based technology that allows your finance team to connect systems, automate processes, and analyze the business. This solution frees your staff from manual processes and complicated spreadsheets, improves compliance with complex regulations, and provides you greater insight into the current and future health of your business.

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