The Association of Accountants and Financial Professionals in Business

The New World of Revenue Management

How CFOs Are Embracing Today's Revenue Models to Bring More Value to the Business

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Introduction

Companies today are converging on new business models such as software subscription, recurring billing, professional services, and product/service bundling, to name just a few. This isn't happening by accident. These new models are seen as huge contributors to a business's valuation. But to take advantage of the opportunities these models present, good revenue management practices are essential.

All of these scenarios require revenue recognition procedures to accurately track what can be recognized and when. Yet, these procedures are wrapped in complex regulations with severe penalties for noncompliance. Add to this the new revenue recognition accounting standard (Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*), and many companies face new and bigger challenges in knowing when and how to recognize revenue.

In May and June 2015, IMA® (Institute of Management Accountants) sent a survey to 6,000 members in the United States, United Kingdom, Australia, and New Zealand to learn how companies are coping with changing revenue business models and how they are assessing their compliance and internal controls in light of the new revenue recognition accounting rules. This report summarizes the survey findings.

Executive Summary

- Overall, about 30% of respondents said the new revenue recognition standards would have either a somewhat or great deal of impact on their company, especially on their revenue processes and financial statements. Almost half the respondents said their firms do not currently fall under any of the Generally Accepted Accounting Principles (GAAP) revenue recognition guidelines given. However, two-thirds of these also said they have not yet assessed the new standards.

- The most commonly indicated recognition guidelines from the new standards are performance obligations (35%), contract modifications (21%), and multiple-element arrangements (MEA) accounting (21%).

- Spreadsheets are still the most commonly used method to track revenue recognition (60%), but the use of purpose-built accounting enterprise resource planning (ERP) applications is a close second (46%) and appears to be on the rise. Many companies realize that revenue recognition standards are changing and that their spreadsheets are inadequate to handle those changes.

- Those using ERP or other purpose-built accounting applications to track revenues had the highest overall satisfaction level (40% "very satisfied"; 51% "somewhat satisfied"). One reason is they no longer have to worry about the fragility of their massive spreadsheets.

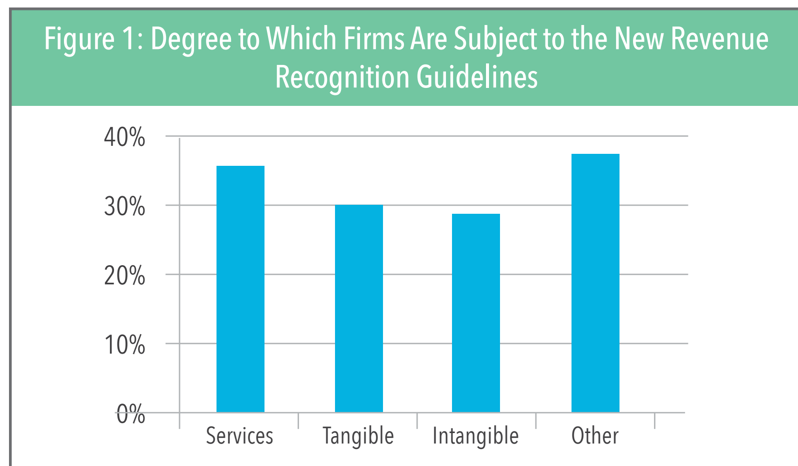
- Customers have the most impact on revenue management decisions, followed by top management support, information systems, staff expertise, and expanding product lines and markets. With market demand shifting to new business models like usage-based subscription billing, companies must adapt and adhere to new revenue recognition standards they didn't have to before.
- Further, the most commonly mentioned triggers of change in revenue recognition methods are changes in billing models, top management decision, better software, and changes to revenue recognition standards. Again, market demand is leading to new billing models, and companies are responding with better software and technology.

Key Findings

Impact of New Revenue Recognition Standards

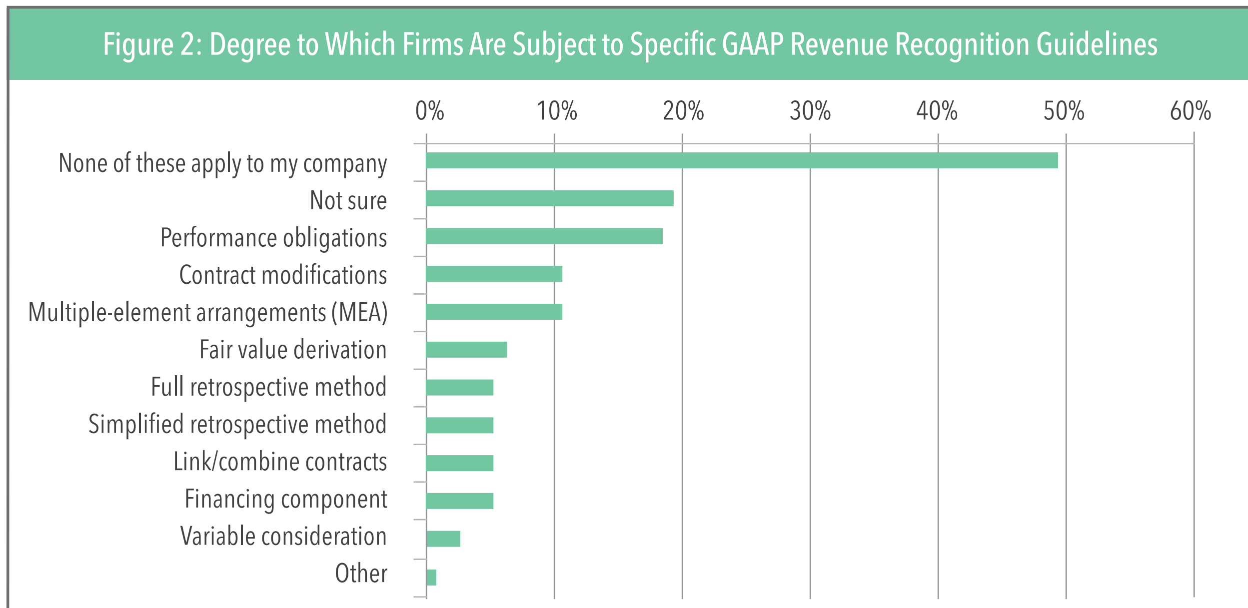
In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606); and the International Accounting Standards Board (IASB) issued International Financial Reporting Standards (IFRS) 15, *Revenue from Contracts with Customers*.

The majority of the respondents in this study work for firms that provide business services (48%). Another 38% produce tangible products, 6% produce intangibles, and 8% other (mostly "all of the above"). Figure 1 shows a fairly even split between the firms that are subject to the new revenue recognition guidelines and those that are not. For each type of business, the percentages subject to the guidelines are 36% of service firms, 30% of those producing tangible products, 29% of those producing intangible products, and 37% of other firms (again, mostly "all of the above").



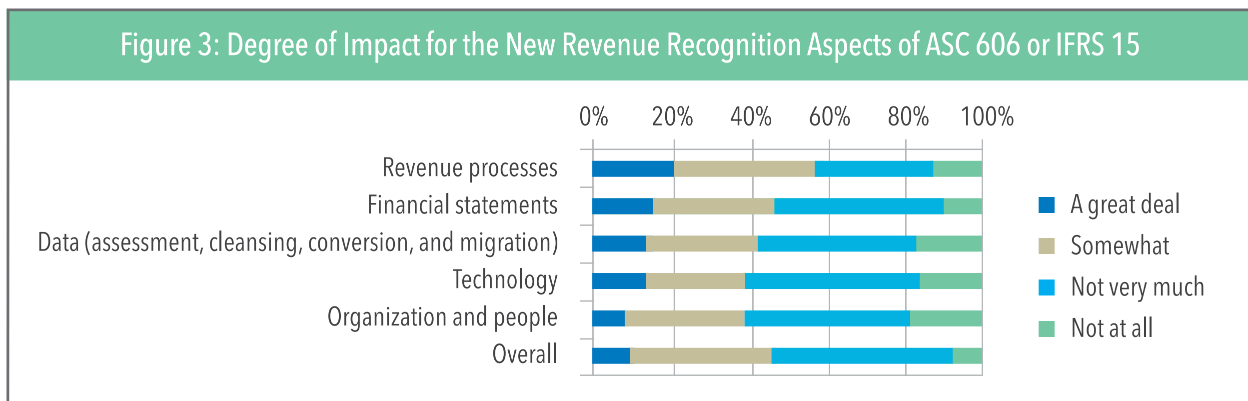
It appears that many companies are either not aware of the new guidelines or, if they are, they haven't done a thorough review of them. Almost half (49%) of the respondents said their firms do not currently fall under any of the GAAP revenue recognition guidelines listed (see Figure 2). But about two-thirds of that 49% also said they had not yet assessed the new cost recognition aspects of the new standards. Another 19% of respondents were unsure if their company was subject to any of the guidelines.

The rest of the analysis in this report is based on the 51% of respondents who said they are subject to the new guidelines. Performance obligations (35%), contract modifications (21%),



and multiple-element arrangements (MEA) accounting are the most commonly indicated guidelines to which companies are subject. The two retrospective recognition methods, the *full retrospective method* (restate two comparative years prior to the implementation date) and the *simplified retrospective method* (recognize effect only on contracts not yet completed at the date of initial application) were each cited by 10% and 9% of respondents, respectively.

Overall, about 46% of respondents said the new revenue recognition standards would have either a somewhat or great deal of impact on their company (see Figure 3). More specifically, 55% said the new standards would impact their revenue processes and financial statements. But while many firms see an impact on revenue processes and financial statements, many have yet to realize new technology and organization changes can actually reduce the impact.



Evolving Revenue Models

As shown in Table 1, there is an approximately 60/40 split between multiple-element and single-element contracts. Billing types are fairly diverse, ranging from fixed price (49%) and deliverable (36%) to time and materials (35%) and a combination of the three (44%). The most common time periods for recognition are annual (44%) and monthly (44%). The most common billing triggers are deliverables/ project milestones (36%) and regular calendar frequencies (36%). The percent-complete method is used by only 27% of respondents.

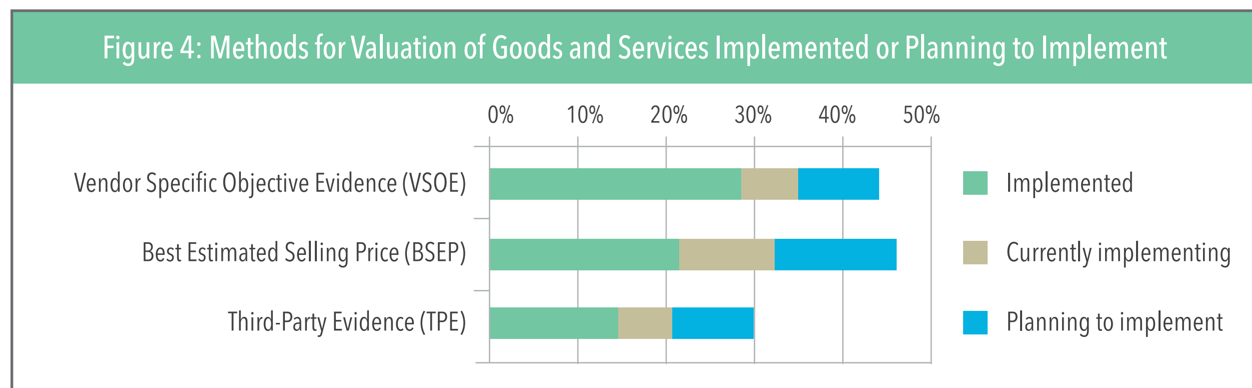
Table 1: Types of Structure for Customer Contracts

Category	Type	Percent
Type	Multiple element	59%
	Single element	41%
Billing Type	Fixed price	49%
	Combination	44%
	Deliverable	36%
	Time and materials	35%
Term	Annual	44%
	Monthly	44%
	Quarterly	27%
Billing Triggers	Regular calendar frequencies	36%
	Deliverables (project milestones)	36%
	Percent complete	27%

Revenue Management Practices

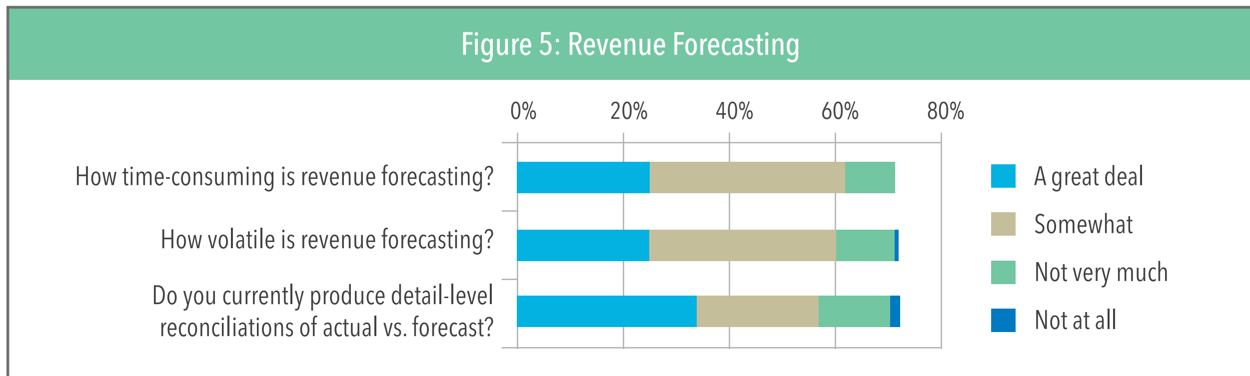
Figure 4 reports the methods implemented for valuation of goods and services. The most common method used is the vendor-specific objective evidence (VSOE), implemented by 28% of respondents. Another 17% are either currently implementing it or planning to. Twenty-one percent report that they have implemented Best Estimated Selling Price (BESP), with another 16% either currently implementing it or planning to.

Figure 4: Methods for Valuation of Goods and Services Implemented or Planning to Implement



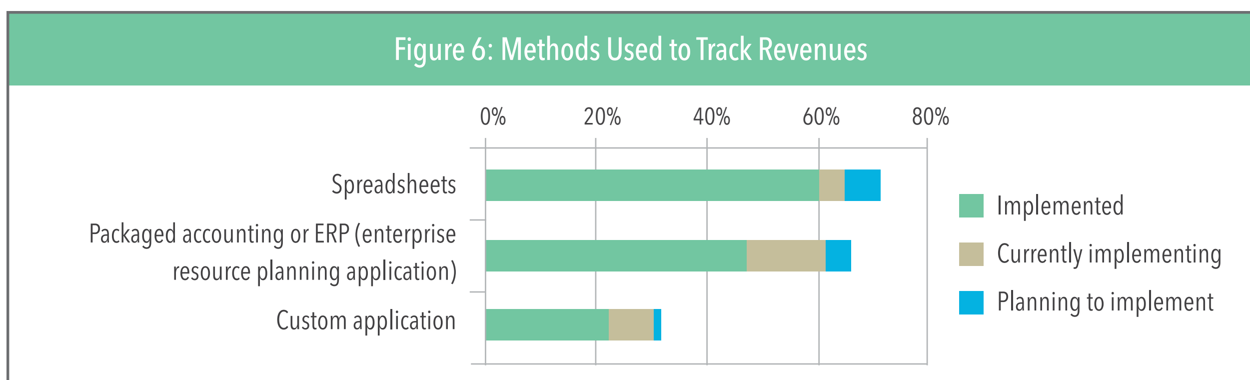
Seventy-four percent of respondents said they incorporate revenue forecasting into their financial reporting. Of the respondents answering this question, 64% said they use spreadsheets in some way for revenue forecasting. Thirty-six percent said they only use spreadsheets, while another 28% use spreadsheets plus some other software. ERP systems are the most common "other" software used.

The survey asked various questions relating to revenue forecasting. When asked if their revenue forecasting was time-consuming, 37% said "somewhat" and 26% said "a great deal" (see Figure 5). When asked about the volatility of their revenue forecasting, the results were similar: 34% said "somewhat," and 26% said "a great deal." Thirty-two percent said they follow the traditional practice of providing detailed-level reconciliations of actual vs. forecast "a great

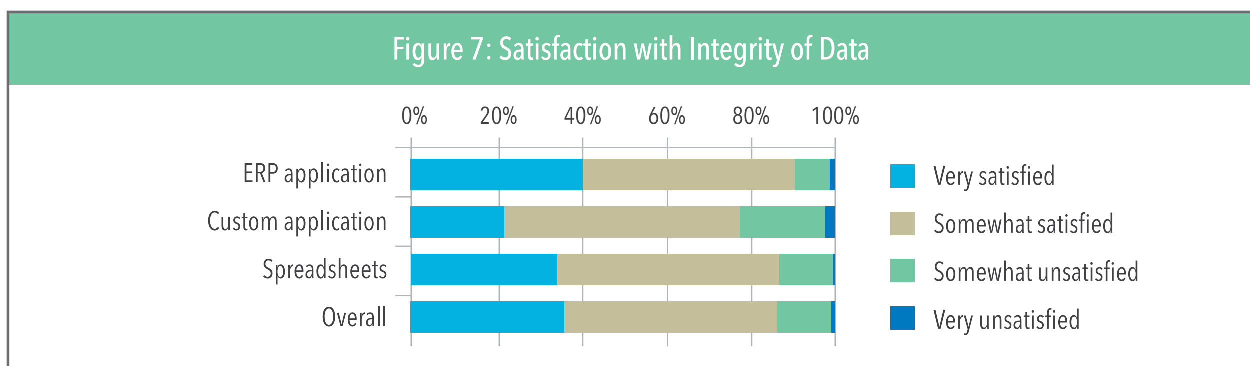


deal," and 23% said "somewhat." Any software solution that enables companies to do forecasting and revenue recognition in one place can help eliminate some of the time-consuming manual elements of these processes.

Figure 6 reports the methods used to track revenue recognition. Once again, spreadsheets are used most (60%), but the use of packaged accounting or ERP applications is a close second (46%) and appears to be on the rise with 21% currently implementing or planning to implement one.

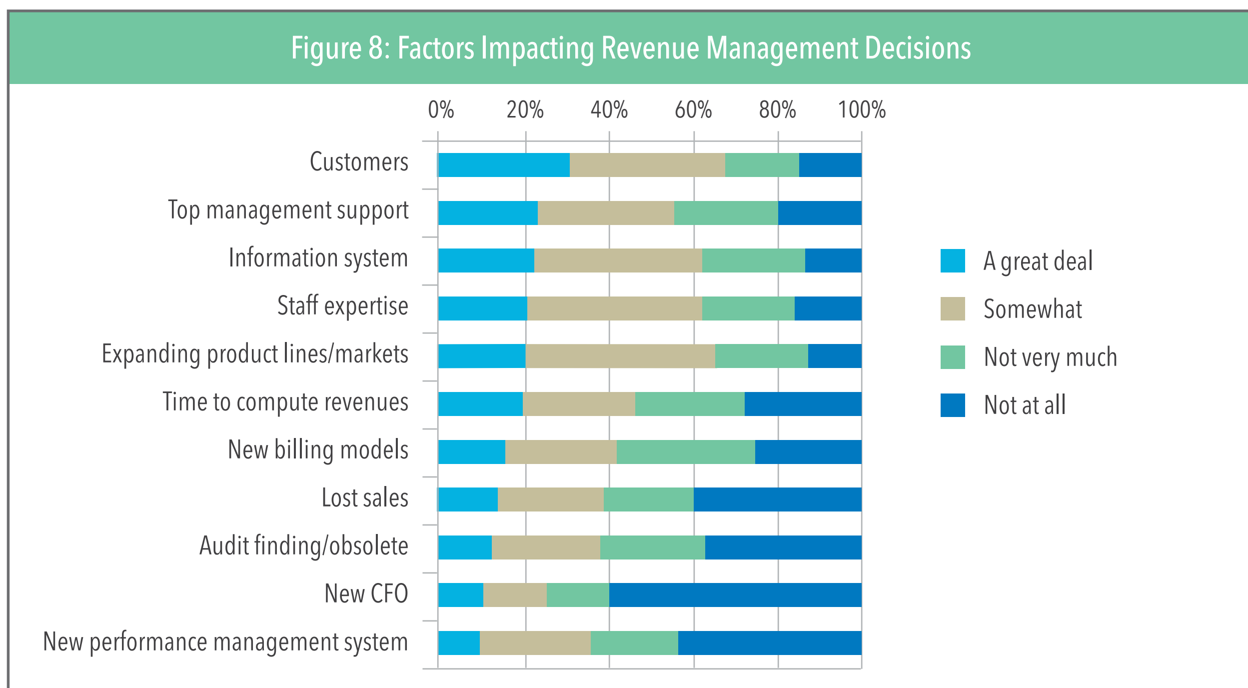


As shown in Figure 7, respondents whose firms are using packaged accounting or ERP applications to track revenues have the highest overall satisfaction (40% "very satisfied"; 51% "somewhat satisfied") with the integrity of data. Spreadsheet users are next with 32% ("very satisfied" and 56% "somewhat satisfied"). Those using custom applications appear to be the least satisfied.



Impact of Various Factors on Revenue Management Decisions

The factor having the most impact on revenue management decisions is customers (see Figure 8). That's followed by top management support, information systems, staff expertise, and expanding product lines and markets, which all play a significant part. Although only 16% of the respondents said that new billing models have impacted revenue management decisions a great deal, we expect that percentage to increase going forward as the market is increasingly demanding new business models, such as software subscription, recurring billing, professional services, and product/service bundling. As more firms analyze the impact of new business models and accounting rules, they will also probably recognize a greater need for new information systems and staff expertise.

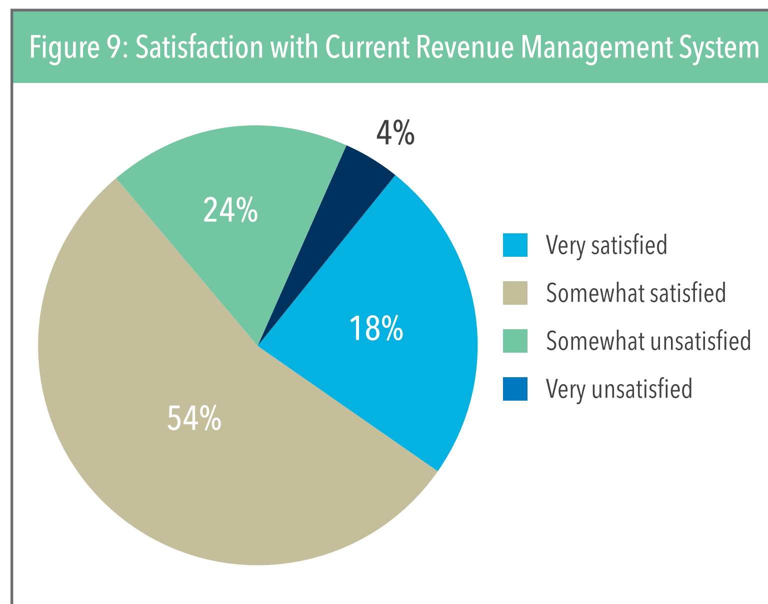


Key Triggers of Change in Revenue Recognition Methods

Respondents were asked what would need to happen for their company to change its revenue recognition system. Below are the most common answers given:

Category	**Example comments**
Change in revenue Recognition standards	• *"A major shift in the real estate management environment, such as industry-wide and specific rulings on revenue recognition in our market."* • *"Clear GAAP requirements to change."*
Change in billing model	• *"Implement progress billing in our ERP system and update our contracts to allow for milestone revenue recognition once Percentage-of-Completion Method of accounting is no longer US-GAAP."* • *"No longer recognizing revenue when products are shipped."*

Better software	• *"Too time-consuming, and error-prone spreadsheets. Currently looking into software solution."* • *"Improvement in systems so less chance of making errors. Reduce the number of ways to recognize revenue so less chance of making mistakes."*
Top management decision	• *"Increased sales and support from the president."* • *"Management approval and complete support!"*



Satisfaction with Revenue Management Systems

When asked how satisfied they are with their current revenue management system, 24% said "very satisfied" and 54% said "somewhat satisfied" (see Figure 9). Of those who are "very satisfied," 54% use ERP systems to track revenue recognition. Although many spreadsheet users said they are satisfied with their revenue management system now, they may not be familiar with the benefits of custom application systems or know how the new revenue recognition standards will affect their financial reporting.

Compliance and Controls

Sixteen percent of respondents have assessed the new cost recognition aspects of Accounting Standards Codification® (ASC) Topic 606, *Revenue from Contracts with Customers*, or IFRS 15, and 30% are planning to assess. Thirty-three percent are somewhat worried about revenue recognition compliance, and 12% are worried a great deal.

Respondents rated the quality of their existing revenue recognition controls as follows:

- Excellent: very strong system controls (prevent and detect) 15%
- Good: combination of system controls and administrative review 60%
- Fair: no system controls, dependent on administrative review (primarily detect controls) 21%
- Poor: weak control environment 4%

Surprisingly, one-fourth of the respondents have either weak or no controls over their existing revenue recognition systems. Thirty percent (30%) of the respondents plan to reassess their systems and controls in light of the new revenue recognition requirements. Another 48% said "maybe" or "not sure." Of course, as more companies assess the new rules, we can expect to see more companies realizing the need to reassess their technology and controls.

Two-thirds of the respondents said there has been no change in the difficulty of revenue forecasting due to changes in the revenue streams. Twenty-three (23%) said it has become more difficult, and 8% said it has become extremely difficult.

Conclusion

As a result of new business models and changes in revenue recognition standards, many companies are reassessing their revenue management practices and controls. Of those who have studied the new standards, about half said the new revenue recognition standards would have an impact on their company—especially on their revenue processes and financial statements. Although almost half of the respondents did not think their firms currently fall under any of the new GAAP revenue recognition guidelines, the majority also said they had not yet assessed the new standards.

The new revenue recognition standards are complex, and many CFOs have not yet assessed the impact on their company. Firms appear to be resistant to making changes in their recognition practices. But with customers increasingly demanding new billing modes, standards changes, and better information systems available, they would be wise to assess the impact of these changes to their companies. There is a good chance the new standards will have at least some impact on their companies' reporting, creating a risk of noncompliance. Dealing with these issues will require top management support, staff expertise, and potentially new technology solutions. Companies still using spreadsheets for revenue forecasting and recognition should especially do an assessment of their revenue management practices.

Appendix: Respondent Demographics

In May and June 2015, IMA sent a survey to 6,000 members in the U.S., U.K., Australia, and New Zealand who identified themselves as CFOs, controllers, directors, or accounting managers. A total of 235 responses were received. Tables 2-6 provide some demographic characteristics of the respondents.

Table 2: Respondents' Job Title

Controller, financial controller, or comptroller	29%
Finance director	9%
Finance or accounting manager	16%
CFO	15%
COO	1%
Other	30%
	100%

Table 3: Type of Organization

Manufacturing	28%
Business services	14%
High tech/software	10%
Finance/insurance	6%
Government	6%
Nonprofit	6%
Education	6%
Wholesale/distribution	5%
Healthcare	4%
Construction and contracting	4%
Retail/e-commerce	3%
Transportation/utilities	3%
Communication	2%
Energy	2%
Media/entertainment	1%
	100%

Table 4: Location of Business Unit

United States	97.90%
United Kingdom	0.40%
New Zealand	0.40%
Other	1.30%
	100%

Table 5: Annual Revenues of Company (U.S. Dollars)

Less than $1 million	12%
$1 million – $10 million	20%
$11 million – $100 million	32%
$101 million – $500 million	13%
$501 million – $1 billion	7%
$2 billion – $5 billion	8%
$6 billion – $10 billion	2%
More than $10 billion	6%
	100%

Table 6: Number of Employees in Organization

Less than 50	28%
51-100	11%
101-200	11%
201-500	12%
501-1,000	10%
1,001-10,000	17%
More than 10,000	11%
	100%