Best Practices in Revenue Reporting

FINANCIAL EXECUTIVE BENCHMARKING SURVEY

Revenue Reporting Edition

RevenueRecognition.com
Revenue Management Resources for Today's Financial Executive

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EXECUTIVE SUMMARY

RevenueRecognition.com in association with International Data Corporation (IDC) recently surveyed 578 business leaders about the need for improvements in their finance processes, with a focus on revenue recognition and related reporting processes. The survey was conducted in July 2007 by email and all responses were on an anonymous basis. More than 80% of respondents are CFOs, Controllers, senior finance executives, internal auditors, or compliance leaders. 110 responses were from companies with revenues of $1 billion or more. References to the data and narrative in this report should be sourced:

www.RevenueRecognition.com and IDC, 2007

Key Findings:

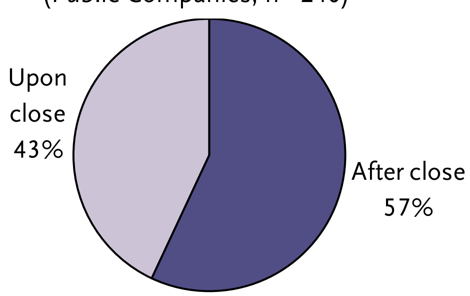
- 57% of public companies cannot finalize their revenue numbers within their monthly close process.
- Delays of up to three weeks are primarily caused by:
  1. Increasingly complex transactions
  2. Required information is not available in time
- The finance processes that are most difficult to establish internal controls for are contract management and revenue recognition.
- The two greatest challenges to ensuring revenue policies are implemented accurately and consistently are:
  1. Managing accounting practices at multiple business units, divisions, and regional operations
  2. Spreadsheets
- Two-thirds of companies produce generalized revenue forecasts based largely on their sales pipeline—as opposed to evaluating the actual revenue impact of current and proposed business.

REPORTING REVENUE

In our last survey, 92% of respondents indicated they use spreadsheets to manually process their revenue data. This is largely because revenue numbers are generated by analyzing delivered goods and services against contractual terms – and that typically means getting at information buried in a multitude of systems such as ordering, contract management, shipping, billing, service tracking, etc. Once the data is collected, accounting guidelines must be properly applied to different line items depending on the nature of the goods and services.

In our latest findings, we measured the impact this has on revenue reporting processes and the news is not particularly good. As Figure 1 shows, only 43% of public companies in our survey are able to finalize their revenue numbers within their normal monthly close process. 57% spend up to three weeks on further analysis and uncovering corrections or adjustments to their revenue numbers after the books were officially closed.

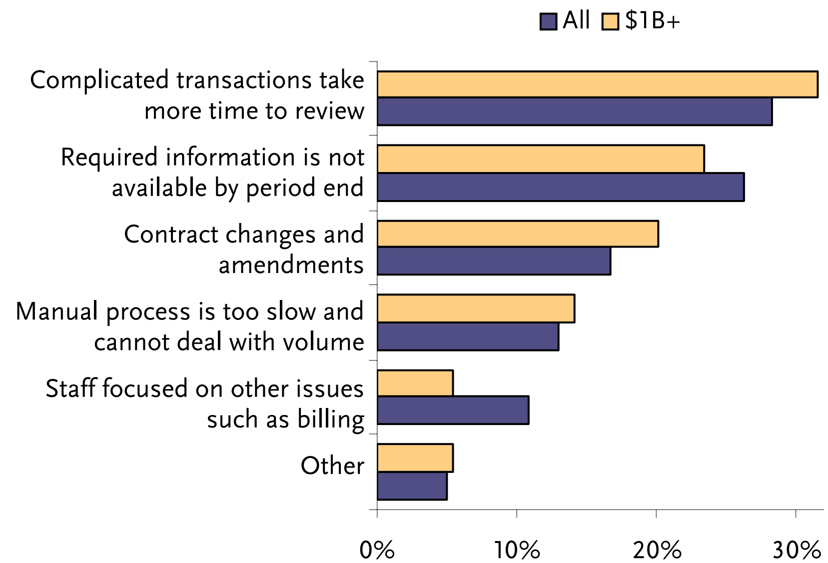
Figure 1
Finalizing Revenue Numbers in the Monthly Close
(Public Companies, n= 240)



REVENUE PROCESSING DELAYS

The time required to review complex transactions to ensure the proper accounting treatments are applied is the number one reason revenue data is not finalized during the normal close process. As Figure 2 shows, this tends to be more of a problem for larger companies, and in certain industries the problem is acute. Over 50% of respondents from computer hardware and software manufacturers and utilities companies ranked this as the number one issue. The second problem is having the right information at the right time. More than 40% or more of respondents from computer hardware, financial services, healthcare services, and transportation companies ranked this number one.

Figure 2
Reasons for Revenue Reporting Delays
(Multiple responses accepted, n= 578, 110)

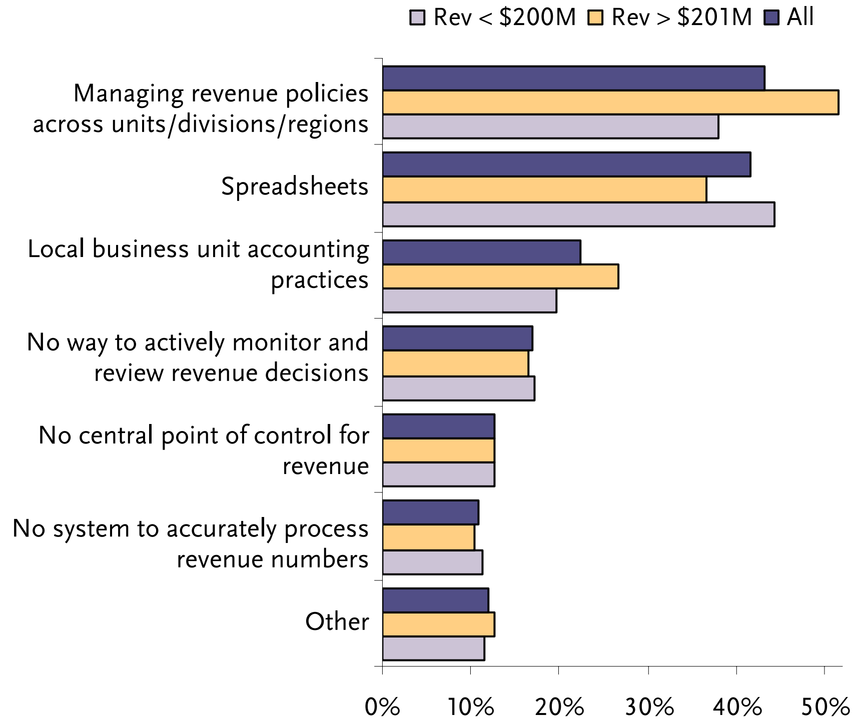


THE REVENUE POLICY CHALLENGE

Transaction complexity is only part of the story. Transactions take place at many locations and at many different levels in a large enterprise. The revenue policy is supposed to be the internal standard for decision-making. But as Figure 3 illustrates, managing accounting practices at local business units, divisions, and regional offices – and the use of spreadsheets – make it difficult to ensure that the revenue policy is implemented accurately and consistently.

The evidence makes it clear that companies lack an enterprise system to control their revenue processes. However, the absence of such a system is not considered a key challenge as disparate systems across business entities are the norm in most companies, and adjustments for accounting treatment have always been a manual process. In our last survey, 84% of companies that thought ERP systems processed all their revenue data reported that they actually used spreadsheets for key revenue related tasks. The implication is management teams are not aware of the limitations of ERP systems in this area, and accounting staffs may be unaware of solutions that are available.

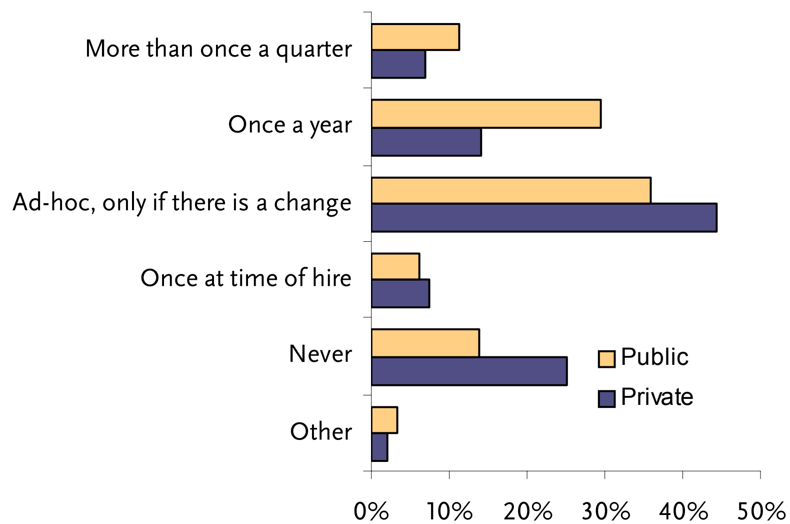
Figure 3
Key Challenges to Implementing Revenue Policies
(n=578, multiple responses accepted)



MANAGEMENT TOOLBOX 101: TRAINING

One of the ways these issues can be addressed is through training. But formal training on revenue policies is not conducted annually at most companies. As Figure 4 shows, the majority of revenue recognition training is done on an ad-hoc basis. Less than one-third of public companies and less than 15% of private companies conduct formal training. Training regimes are in fact non-existent at nearly 15% of public companies and fully one-quarter of private firms.

Figure 4
How Often Do You Conduct Formal Training on Your Revenue Policy? (n= 240 Public, 348 Private)



REPORTING PRACTICES – INTRO

Reporting practices must effectively support the presentment of revenue numbers for different requirements. Figure 5a shows that 85% of all respondents report on GAAP and nearly 50% have to produce consolidated data. As organizations must adhere to multiple reporting requirements, revenue recognition processes and analysis become more complex, and reconciliations become more time consuming.

Figure 5a
Revenue Reporting Criteria (n=578)

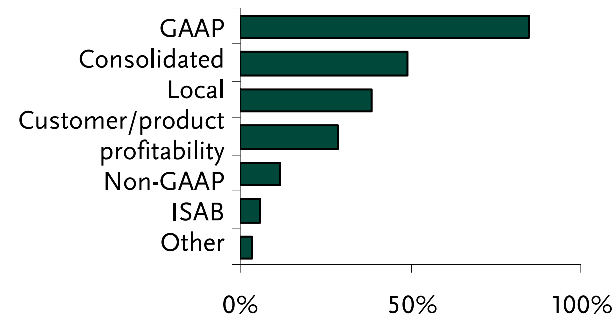
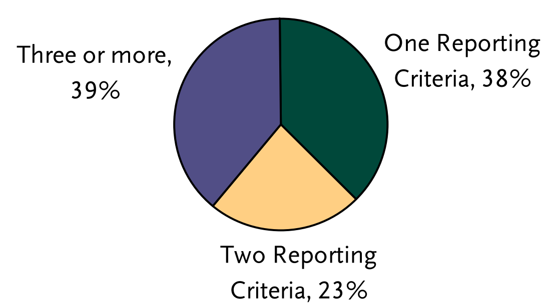


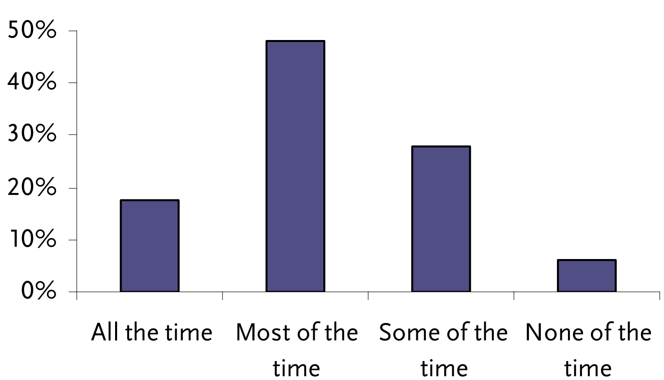
Figure 5b
Number of Revenue Reporting Criteria (n=578)



REPORTING PRACTICES – FMV/VSOE

60% of the companies in our survey are required to use Fair Market Value (FMV) or Vendor Specific Objective Evidence (VSOE) in their revenue recognition analysis. Less than 20% of companies that need to establish values for FMV/VSOE are able to do so regularly. The computer manufacturing industry had the highest number of respondents saying they could meet requirements, but even in this group only 36% made this claim.

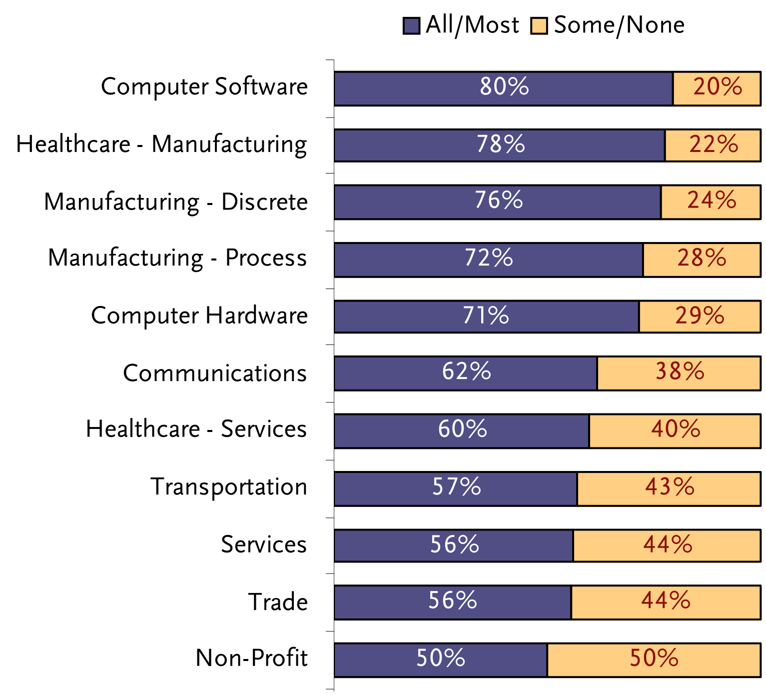
Figure 6
When Required, How Often Can You Establish FMV/VSOE? (n=344)



REPORTING PRACTICES – FMV/VSOE BY INDUSTRY

The relevance of FMV and VSOE varies greatly by industry. High tech companies are typically the only ones grappling with the vagaries of VSOE, but FMV is more widely applicable. Figure 7 shows that companies in every industry are unable to establish FMV/VSOE with 100% consistency.

Figure 7
Ability to Establish FMV/VSOE When Required, by Industry
(n=304, "Other" omitted)

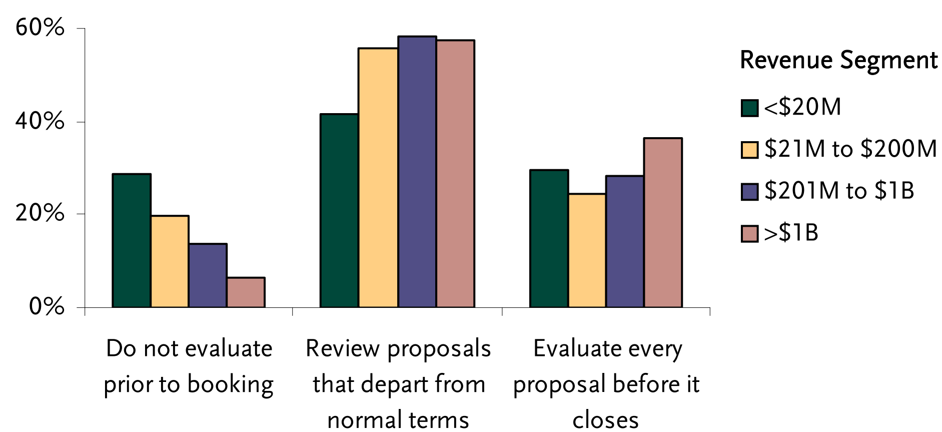


REPORTING PRACTICES – PRE-BOOKING ANALYSIS

Many of the challenges that occur with revenue recognition can be better managed if processes are in place to evaluate proposed business transactions for revenue impact prior to booking. More importantly, this is an opportunity to optimize contracts for future revenue performance. As shown in Figure 8, most companies do review proposals that depart from their normal terms. Companies that analyze the revenue impact of every proposal prior to booking close their books on average one day sooner than companies that do not.

Figure 8

What is the process to evaluate proposed business such as quotes or draft contracts for revenue impact prior to booking? (n = 578)



REPORTING PRACTICES – FORECASTING

Revenue forecasting is an extremely complex process at most companies because many different contractual conditions apply, and multiple assumptions are made about future events. The most thorough method is to systematically evaluate all current and proposed business for future revenue impact. But this is difficult, especially for businesses that have long-term customer arrangements involving multiple products and services, and/or high volumes of transactions. Only about one-third of companies in our survey evaluate all current and proposed business as part of their revenue forecasting process. Most, as shown in Figure 9, rely mainly on their sales bookings forecast to drive revenue forecasting.

Figure 9
How do you convert a sales forecast into a forecast for recognized and deferred revenue? (n=578)

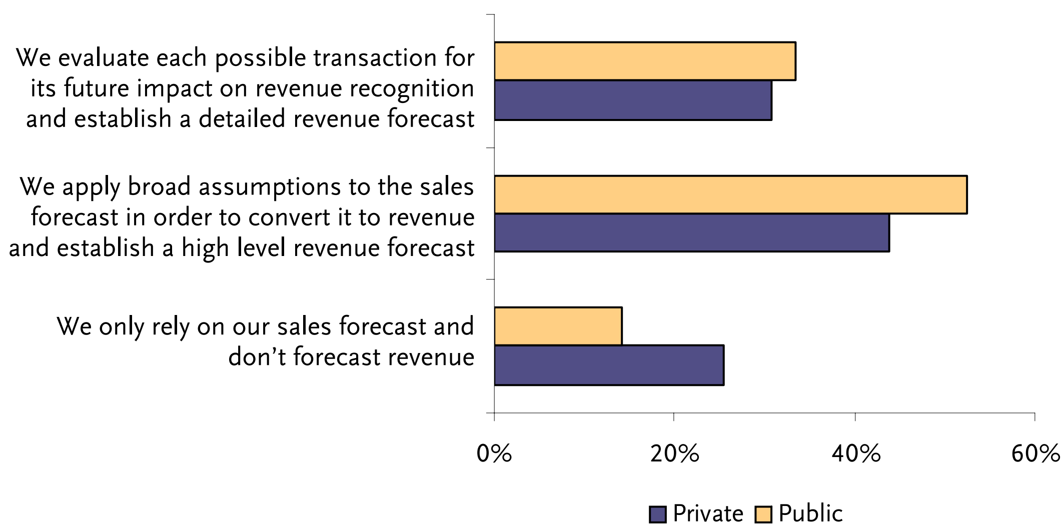
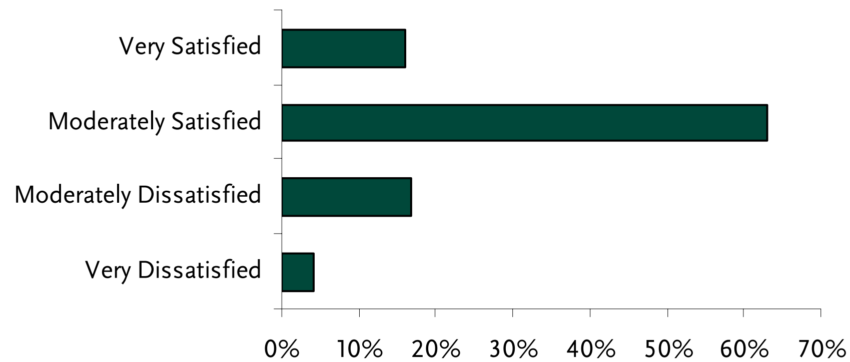


Figure 10 shows how satisfied respondents are with their ability to forecast recognized revenue for future periods. Nearly 80% are moderately or very satisfied. The question is: should they be? Applying broad assumptions to their sales bookings forecast, as most companies said they do in Figure 9, can lead to revenue forecasts that do not properly account for recognition treatments in the details of the contract terms, and also miss the opportunity to manage performance by optimizing contracts for future revenue performance.

Figure 10
How satisfied are you with your ability to forecast recognized revenue for future periods? (n=578)



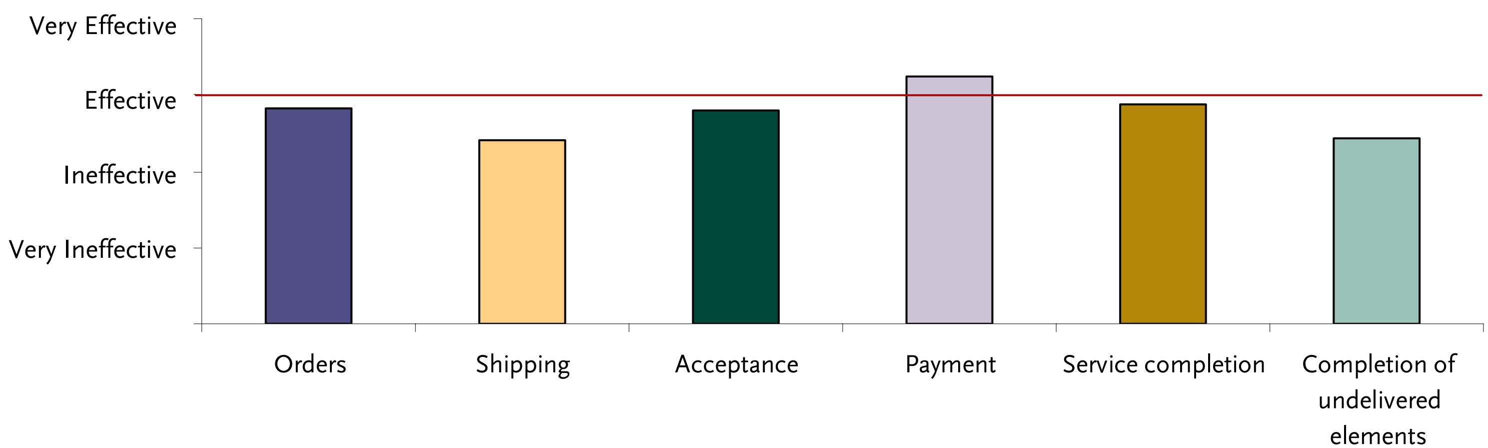
REPORTING PRACTICES – EVENT MONITORING

Certain business events are triggers for recognizing revenue. The most common and significant of these are listed in Figure 11. Respondents were asked to use a four point scale to rate how well their revenue management teams are able to monitor these events.

These events are so basic that anything less than an "effective" rating should be cause for concern. In our survey, only Payment events averaged "effective" or higher.

Larger companies rated themselves slightly higher across the board than smaller ones. Public companies rated themselves slightly higher than private ones. Those running multiple business models also generally rated themselves higher than those running single business models. One explanation may be that each of the higher rating groups is further along in terms of deploying technology to address key accounting processes.

Figure 11
How Effectively Are Revenue Management Teams Monitoring Key Events? (n = 578)

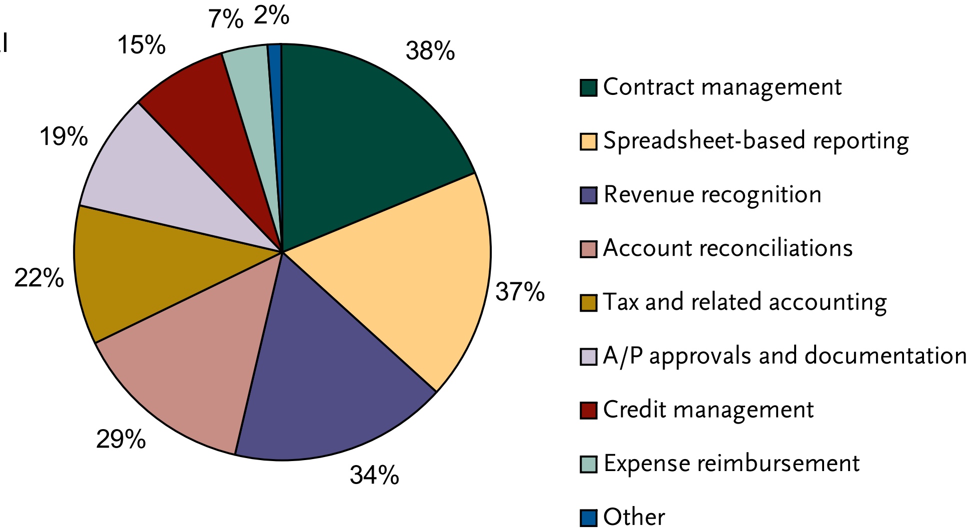


REPORTING PRACTICES – INTERNAL CONTROLS

The process of revenue reporting draws on information from a variety of other processes and data sources. Having effective internal controls across all of these areas is necessary to make the revenue reporting process reliable and auditable. However, companies have some serious challenges in establishing effective internal controls for revenue related processes. As shown in Figure 12, contract management again tops the list of the most difficult areas to establish effective internal controls. This is significant because critical revenue recognition decisions depend on contractual terms, so any weakness in controls over contract data adds risk to the whole revenue reporting process.

Spreadsheet-based reporting is a new item on the list this year. It did not outrank the challenges in contract management even though spreadsheets are inherently resistant to the application of controls. Revenue recognition also ranks in the top three on this survey question every year. These results indicate that internal controls across the entire revenue reporting process – from contract through account reconciliations – need attention.

Figure 12
Most Difficult Areas to Establish Effective Internal Controls
(Multiple responses accepted, n = 578)

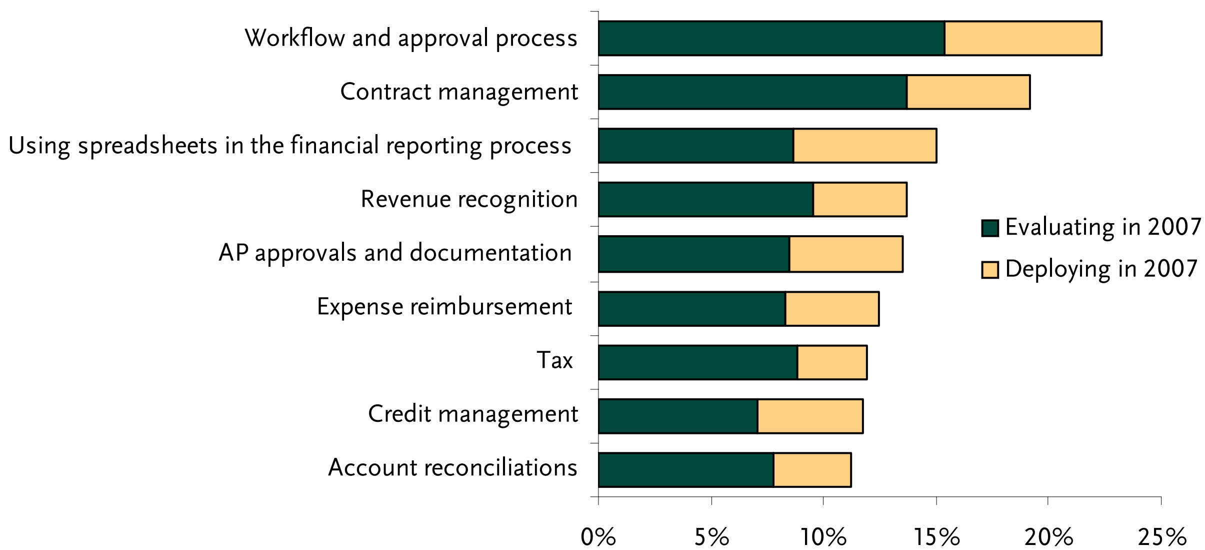


REPORTING PRACTICES – TECHNOLOGY

Given the conclusions drawn from Figure 12 it is reassuring to see alignment between control issues and the types of technologies companies are evaluating and deploying in 2007. The number one area of technology investment in Figure 13 is the workflow and approval process which supports the overarching control environment for accounting processes. Organizations can then use the automated routing and approval process to connect to other systems they may be implementing.

Figure 13

Plans to Evaluate and Deploy Technology for Accounting Processes in 2007 (n = 578)



SUMMARY

Revenue reporting processes are a matter of vital concern to investors and executives alike. The fact that revenue numbers are typically not finalized during the normal close process at most companies can have serious consequences, especially if adjustments are material, and public financial results are misstated.

Better efforts are necessary. Complex transactions are the leading cause of revenue accounting challenges—a clear sign that underlying processes and systems have not kept up with the pace of change and innovation taking place in every industry. Actively managing the revenue policy and controlling the data and decision-making that supports reported revenue should be an automated process.

Consistent processes for establishing FMV/VSOE, pre-booking analysis, event monitoring, forecasting, and internal controls are emerging but have not evolved to the point of best practices—companies that strive to manually support best practices cannot do so within standard financial close timelines.

The fundamental issue is revenue reporting processes are not "baked-in" to the financial systems infrastructure. Senior executives, especially those at public companies, realize that the potential exposure of weaknesses in revenue recognition processes is a key reason to make automation a priority for their finance organizations. When implemented properly, automation can lower the risk of reporting errors and restatements; positively impact investor confidence in revenue numbers; and deliver better information for managing business performance.

DEMOGRAPHICS

Figure 15
What is your company's main industry? (n=578)

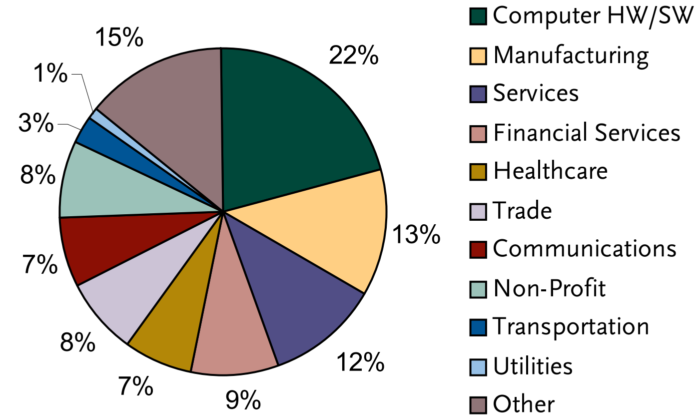


Figure 14
What is your title? (n=578)

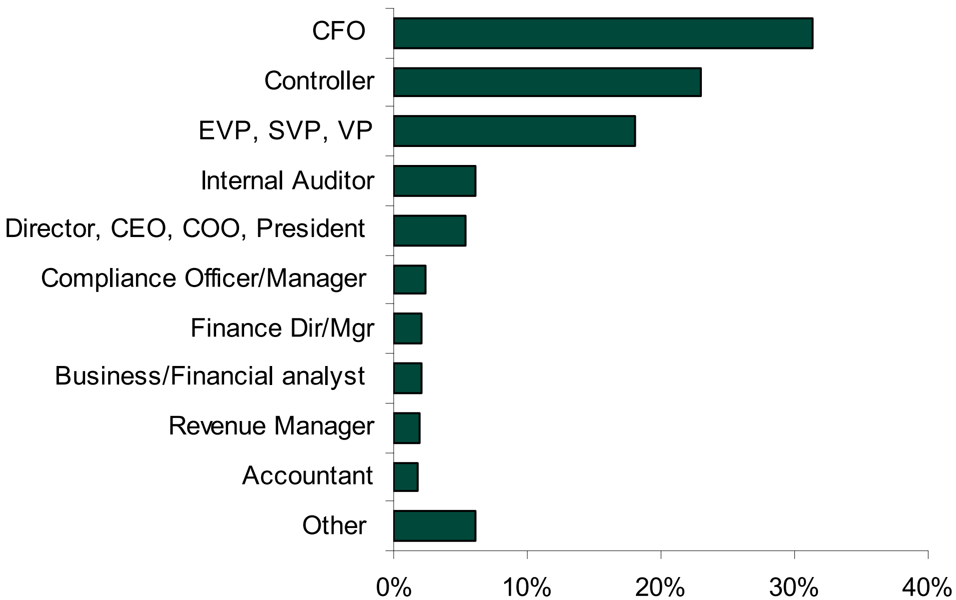


Figure 16
What was your company's approximate revenue in 2006? (n=578)

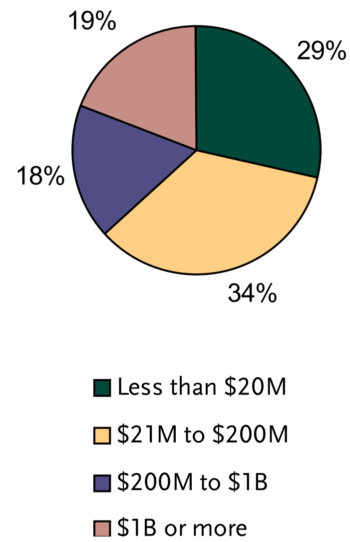
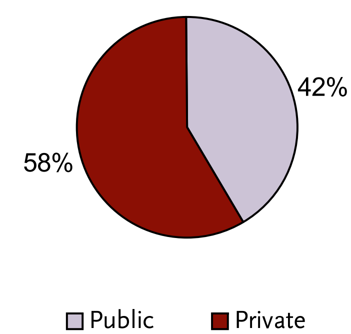


Figure 17
What is the ownership structure of your company? (n=578)



ABOUT REVENUERECOGNITION.COM

RevenueRecognition.com is dedicated to educating finance professionals on revenue management and related issues. The site focuses on revenue accounting; revenue recognition; revenue reporting and forecasting; internal controls; Sarbanes-Oxley compliance; SEC, FASB, and international accounting guidelines; contract management; and industry specific revenue challenges. Contact us at: info@revenuerecognition.com.

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