Complete Billing and Revenue Management Solutions

WHITEPAPER

A Guide to ERP Augmentation for Improved Billing and Revenue Recognition

What's Inside

If revenue management hasn't yet become a challenge using your company's enterprise resource planning (ERP) system, there's a good chance it will. Chief financial officers, accounting managers, and finance directors in a wide range of industries have already begun to realize their ERP systems are, on their own, simply not up to the task of navigating through the perfect storm brought on by major changes to their companies' business models (due in part to migration to subscription-based business models), new and coming changes in regulation, and increased focus by auditors on accurate financial reporting. This explosion in change has gone beyond the capacity of any single ERP vendor to keep pace and has caused the need for specialization.

But, is the classic ERP system a lost cause? Is it a relic of another era? Most financial professionals hope not, but there are certainly those out there already heralding the "death of ERP." Without a way to fill the billing and revenue recognition gaps caused by recent disruptions in the business landscape, it can certainly seem the continued investment in ERP software is an investment in an outmoded way of doing things.

This paper is for financial professionals who believe their ERP systems are too valuable and too critical to their businesses to tolerate the painful risk and disruption that a "rip-and-replace" strategy would bring. If this is you, we have good news and bad news. The bad news is what you have long suspected is true; off the shelf, your ERP package is no longer up to the challenge of performing complex revenue management in the modern marketplace. The good news is it doesn't mean it's time to do away with your ERP altogether. As this guide will discuss, the right augmentation strategy will allow your company to continue to benefit from the many advantages of your existing enterprise resource planning software while improving the accuracy, compliance, and auditability of your key revenue management processes.

When Revenue Management Becomes Difficult

There are a number of reasons companies that previously had few problems with revenue management find themselves suddenly facing a challenge. All of these reasons have to do with change – either changes in the business itself, changes in

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the regulatory climate in which the business operates, or changes in the way auditors enforce these requirements. Changes in Business Model

Many companies have transitioned in recent years from a traditional sales model to a subscription-based one. Companies like the stability that a focus on annually recurring revenue brings. With this new model has come a desire to maximize market share by offering various value based pricing plans and bundling offers in a variety of ways. For these companies, where revenue management used to be fairly simple it is now not nearly as cut and dry. Bundled offerings are subject to the multiple element arrangement (MEA) accounting rules under ASC 605-25, which may include a need to establish and maintain fair value for each line-item and perform either reallocation, carve outs, or both. Value pricing implies that the cost of the subscription can increment or decrement based on an overall usage metric and also based on selection and de-selection of incremental functionality, making billing and revenue recognition tasks a nightmare.

Regulatory Changes

In addition to their own internal changes, companies have to adapt to frequently changing regulatory requirements, as well. A big change will occur as new revenue recognition guidelines are on their way as the result of a joint effort of the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to converge on a common accounting standard. Designed to help investors and other analysts compare companies on a level playing field, the standards include new provisions for how and when companies with complex billing arrangements and subscription models can recognize revenue. These changes could affect almost any company, regardless of industry. While they might make revenue recognition easier for some companies, a number of verticals, including manufacturing, will find revenue recognition to be more complex.

Responding to Changes in Audit

As many financial professionals will attest, the true definition of regulation comes with the stamp of approval from your auditors. However, what auditors do and do not approve is always changing and many companies find themselves under more intense audit pressure due to conditions both inside and outside of their company.

In the large scale manufacturing vertical, for example, a recent string of accounting scandals is driving auditors to become more rigorous. One of the most recent examples occurred in early 2013, when construction equipment giant Caterpillar found itself paying a $580 million impairment charge after acquiring a Chinese mining equipment company that had failed to properly recognize its revenue and thus had grossly overstated its profits.

In any industry or market vertical, a more stringent interpretation of regulations can make a restatement necessary. Auditors, sensing that an embarrassing restatement requirement could be in the cards for their client companies, will increase their audit pressure to ensure the more stringent definition of the regulation is being enforced.

However, there's no guarantee that existing client processes and automation can handle this new level of rigor and they are often forced to either customize their existing systems (most often an enterprise resource planning system) or move key process to spreadsheets.

The Role of ERP Systems in a Changing Climate

Up until very recently, enterprise resource planning (ERP) systems were the dominant tool for handling billing and revenue recognition. These monolithic software packages—from major vendors like SAP, Oracle, and Microsoft—can do a lot of things outside of the accounting realm: customer relationship management, human resources, supply chain management, project management, and so on. In the era when the path from order to revenue was much less complex, it only made sense that revenue recognition and billing were included among the many functions of a company's ERP. Why learn a new system if you didn't have to?

The problem, though, is that many ERP systems are a "mile wide and an inch deep." They're built to be useful for the largest number of users, and therefore, fall short of providing certain specialized functions. This forces companies that have those needs to move their key processes outside of their ERP system and onto manual or custom processes. Whenever a company has to do that, it's time for a serious reevaluation of the situation.

The Death of ERP?

Some observers have begun to ring the death knell for enterprise resource planning. After all, if such an important function as revenue management has to be done manually, what good is an ERP system? Would it not be better to replace the ERP system with a software package built from the ground up to handle such complex functions?

For most businesses, the answer is no. An ERP system is often tied to many different aspects of a business; the level of disruption caused by a complete "rip and replace" would be immense and seemingly never-ending. Consider the following:

- **It's easier said than done.** Removing an ERP system and replacing it with something else would require retraining your staff, realigning their skillsets, and gaining buy-in across the enterprise. None of these are easy to accomplish, especially if the ERP has been in use for several years and employees have gotten used to it.
- **A lot could go wrong.** When you're migrating off such a huge and critical system, the potential for error is enormous.
- **Data could get lost or altered.** Companies are very protective of their data these days. A major ERP migration project would require meticulous attention to detail throughout the entire transition to ensure no data slips through the cracks.
- **The project could go over budget, past deadline, or both.** How long can your business afford to function at less than one hundred percent? According to a frequently-cited 2010 report by Panorama Consulting, 57 percent of ERP implementations take longer than expected.
- **The cost of a replacement system can be significant.** The costs involved would not just be for new software, but for implementation and customization, as well.

The consequences of these difficulties go far beyond headaches and frustrations. The enterprise-wide disruption of business caused by completely removing an ERP system and replacing it with something else could significantly affect a company's bottom line, its stock price, and its reputation with its customers. Here are just a few "horror stories": [1]

[1] "10 Famous ERP Disasters, Dustups and Disappointments." CIO. 24 Mar. 2009. 30 Nov. 2013 http://www.cio.com/article/486284/10_Famous_ERP_Disasters_Dustups_and_Disappointments.

- Complications with a cobbled-together amalgamation of ERP, CRM, and supply chain software stopped candy company Hershey from delivering $100 million worth of chocolates before Halloween 1999 and triggered an 8 percent drop in its stock price.
- In 2004, computer company HP tried to centralize the different ERP systems it used in North America into a single system. According to HP's then-CIO, a "series of small problems" compounded to cost HP $160 million in order backlogs and lost revenue.
- Shoe and apparel maker Nike lost $100 million in sales and suffered a 20 percent drop in its stock in 2000 in a huge ERP, supply chain, and CRM project.

What it all boils down to is that the devil you know is often more palatable than the devil you don't. It's often the case that companies go through the significant trouble of removing and replacing their ERP systems, only to find that while they may have solved their revenue recognition and billing problems, they're now forced to turn to manual or custom-built solutions for everything else they did with their old ERP. The truth is, ERPs and other financial systems still have their uses and can remain a robust backbone for the exchange of data. In most cases, you will find that solving the billing and revenue recognition challenge without replacing your company's ERP is the preferred solution.

ERP Augmentation Options

It is clear ERP systems on their own can't handle the complex needs of many modern companies for billing and revenue recognition. It is equally clear that completely replacing an ERP system would be disastrous for most businesses. However, there is a way around this seemingly untenable problem. A middle ground in the form of ERP augmentation does exist.

ERP augmentation just means continuing to use an ERP system but supplementing it with other processes for the handling of functions the ERP system can't. Two of the most common solutions companies try involve spreadsheets or other manual processes or resorting to the creation of a custom (hand coded) revenue management component. Neither option is ideal. Here's why:

Using Spreadsheets for Revenue Recognition

Our last white paper, "Improving Billing and Revenue Management: A Guide for Getting Off Spreadsheets," was about this very topic. The clear upside to using spreadsheets for revenue recognition is that the tool for doing so, a spreadsheet application like Microsoft Excel, is already in use and widely understood at most companies. As discussed in our white paper, the downsides are many:

- **Lack of an audit trail.** When processes and data are spread through several different spreadsheets, systems, and personnel, documentation of the overall order-to-revenue process will not be readily available.
- **Potential for human error.** With a spreadsheet-based system, human involvement in the transfer of information is necessary. Any systems that require human touches will, as a consequence, have a higher potential for human error. This is especially problematic as an enterprise grows.
- **Lack of security and controls**. Manual, spreadsheet-based systems lack the key security features that are required for compliance with federal regulations.

Custom Coding Solutions

A more common approach than using spreadsheets is for companies to custom code their own revenue recognition and billing solution. This is an especially popular approach among software companies that already have a team of software engineers on staff.

In fact, it can be said that most ERP implementations require a certain amount of custom coding. One estimate claims that 40 to 60 percent of ERP implementations require custom coding. This is because ERPs are so vast and all-encompassing, and at that large scale, companies vary significantly in the way they do business.

In some ways, custom coding seems to be a better solution than outsourcing because it gives companies control over their own destinies. No one understands your company's complex billing and revenue models better than you, after all. Custom coding also seems to be less expensive than outsourcing because all the work is done in-house.

But seems can be deceiving. Companies often discover that building their own billing and revenue recognition solution turns out to be a riskier and more expensive undertaking than they initially imagined, particularly when considering total cost of ownership (TCO).

Revenue recognition can get very complicated very fast. While a company might have its own team of software engineers, that doesn't mean those engineers have the expertise necessary to build a piece of revenue recognition software that will adhere to current regulations and that will adapt to any new regulations. Often a heavy level of experience is required to architect a system robust and flexible enough to not only handle the myriad of requirements of today, but also whatever changes in requirements tomorrow could bring.

Critical capabilities like security (logging and access control) and auditing and reporting are difficult to code and thus are often left out of a custom coded solution. If they are included, they need to be maintained, further increasing the cost of a custom solution. Complex elements like encryption and multi-level access control require specialized development skills to implement correctly.

As with most enterprise software, billing and revenue recognition software is only as good as the support it receives. When you build your own custom revenue recognition solution, however, that solution is supported by exactly one company: yours. Why is that a problem?

- The onus for keeping up with changing regulations is entirely on your company. Your solution won't change with new regulations unless you change it.
- The more companies use a particular software solution, the more stable it is. A homegrown solution lacks the benefit of rapidly stabilizing after regulatory changes due to widespread use by a variety of individuals and companies.
- Keeping up with upgrades to your ERP systems is much more difficult. Every time you upgrade your ERP, you have to reapply the custom code, which is often undocumented or created by people who no longer work for your organization. But sticking with an older version of an ERP system just to preserve the custom coding will expose your company to a higher risk of attack from viruses and malware.

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- When errors occur, there is no one to turn to. The full responsibility for troubleshooting and immediate remediation of problems falls to the developers that built the solution, and you better hope they're still with your company.
- Custom solutions expose your company to liability. If errors in the custom-built software spawn subsequent accounting errors in your company's books, auditors and regulatory bodies will place full responsibility on the company that created the custom code: yours.
- If you lose the people responsible for the construction of the custom solution, your only recourse is to try to train a new person on someone else's pet project. This rarely goes well.

One corporate IT expert said in 2009, "Customized ERP software can hamper growth strategy. For example, I ran into one company that wanted to implement scheduling software, but the solutions the IT staff evaluated called for a more recent version of the ERP software. The company was stuck with its highly customized older version, so it had to develop custom interfaces."

A Better Solution: Vendor-Supplied Augmentation

A more robust and—in the long run—more affordable solution than custom coding or manual processes is to augment your company's ERP with an add-on module built by a vendor specializing in revenue management. These commercially available, off-the-shelf, modules are superior to custom-built solutions because they are built by specialists. Further, if necessary they can be placed and replaced at a reasonable cost and with minimal disruption, enabling a company to keep pace with its required rate of change without having to resort to expensive customizations.

"Plugin" is a good word for this type of solution. Because your vendor will likely specialize in revenue recognition and complex billing, it's possible your add-on module will never have to be replaced. However, if it ever does, it can be unplugged and a new module that's more aligned with your new requirements can be put in its place.

The Benefits of a Vendor-Supplied ERP Module

Working with a vendor for ERP augmentation has several advantages:

- The burden is on the vendor, not your company, to keep up with the latest regulations.
- A vendor solution has been tried and tested with many other companies. Most of the wrinkles have already been ironed out.
- Because a plugin module can "talk" with an ERP, data can be tracked through both systems for auditing purposes.
- Modern integration and data technologies have streamlined the process of augmenting your existing ERP with these off-the-shelf modules.
- ERP plugins come complete with the security, controls, and innate support for reporting and auditing.

Despite these benefits, some companies are still wary of a vendor-supplied "best of breed" ERP augmentation. Historically, they have been concerned about integration, no longer having all data in one place, and, as a consequence, difficulty creating reports. Those concerns were valid years ago, but have gone away for the most part with modern technologies such as web services and integration layers. They can easily be overcome by shopping around for the right augmentation vendor.

An ERP augmentation solution should do just that: augment a company's existing ERP, not supplant it or force companies to split their processes across two different systems that don't communicate with each other. Vendors should be chosen based on their ability to truly integrate their solution with your company's ERP so that all your critical financial data can be accessed through the same systems and reporting, which is so important for audits, is simplified, rather than made more complex.

What to Look for in an ERP Augmentation Vendor

While the risk of making a mistake with an ERP augmentation is much lower than if you are buying an entire ERP platform, it's still important to exercise due diligence when selecting your vendor. Things to look for include:

- *A track record of successful deployments.* A vendor's experience in the field can speak volumes about how they'll perform when it comes to your company's needs. Having the right technology is only half the story; they also need to be able to demonstrate that they know how to implement it. How many successful deployments a company has under its belt can be an important metric here, especially if they've taken place on a variety of platforms.
- *Experience with your ERP platform.* The market for ERP solutions is a large one, and each system and platform comes with its own quirks. The better a vendor knows your platform of choice, the more successful the augmentation process will be, and the lower the risk of cost and schedule overruns becomes.
- *The depth of their solution.* ERP systems are generally designed with a one-size-fits-all approach in mind, which can be both a strength and a weakness. ERP augmentation is different; since you're trying to shore up one specific portion of your existing platform, you'll want a highly specialized product – one that offers depth where your ERP platform offered breadth. A vendor who focuses on a few specific areas is also likely to have significant experience and expertise within those fields, which enhances the value and quality of their solutions in turn.
- *An understanding of your issues and needs.* Companies can differ as much as ERP systems; a small software startup has substantially different needs from a large, established manufacturing company. Before committing to a solution, it's critical to make sure that the vendor fully understands what you're after and is actually able to deliver on it.
- *Experience.* The old adage that there's no substitute for experience holds true in ERP augmentation as well. An established vendor who's worked with a variety of company types will generally be in a better position to get you to where you need – and can potentially anticipate issues even you might not have considered yet.

Industry Leading Revenue Management Solutions from SOFTRAX

SOFTRAX's industry-leading revenue management solutions are built by dedicated experts with years of industry experience to work with and alongside any of the major ERP systems in use in the business world today. Integrating SOFTRAX's solution with their existing ERP systems allows businesses to automate the entire revenue cycle, from revenue recognition, reporting and forecasting, through complex billing and contract renewals. Hundreds of corporations benefit from using SOFTRAX to:

- Optimize their revenue.
- Reduce operating expenses.
- Comply with revenue recognition regulations and Sarbanes-Oxley requirements.
- Gain unprecedented visibility into their business performance.

If you're interested in seeing how a complex billing and revenue recognition solution like SOFTRAX will benefit your company, click on the image below to take a free online product tour.

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